S&P Global
Market Intelligence

American International Group, Inc. NYSE:AIG

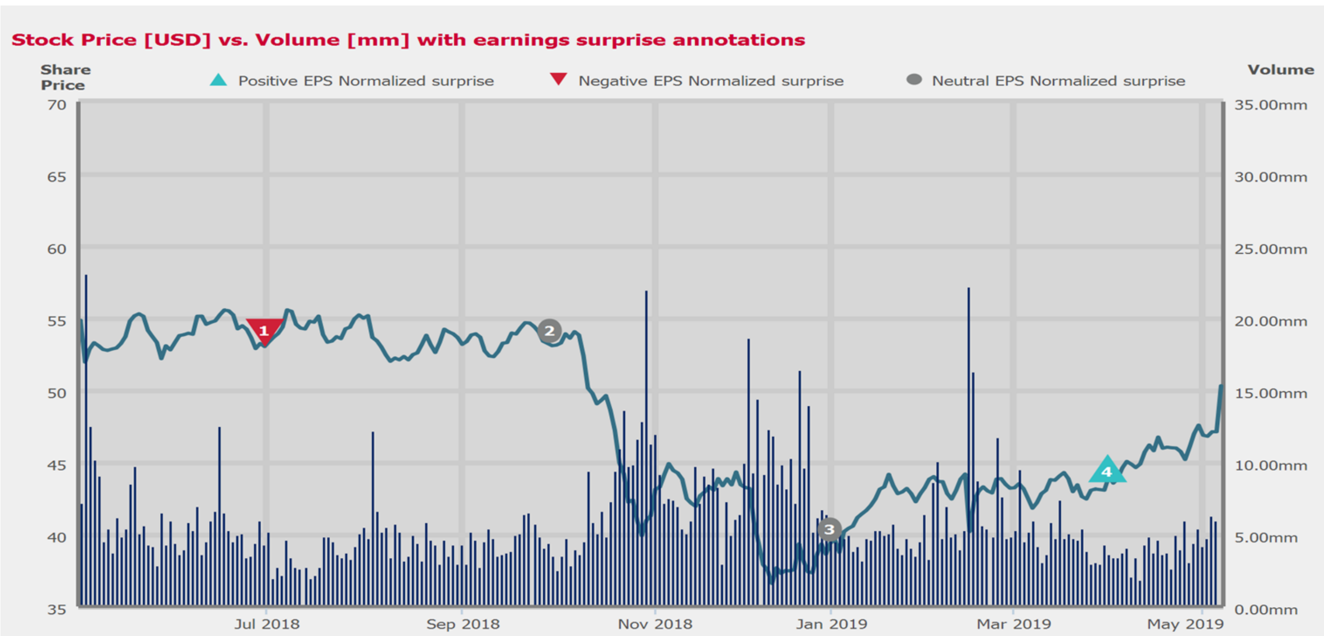
FQ1 2019 Earnings Call Transcripts

Tuesday, May 07, 2019 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2019-			-FQ2 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.06	1.58	▲49.06	1.13	4.62	5.08
Revenue (mm)	12246.49	12456.00	▲1.71	12083.24	48929.24	49302.03

Currency: USD
Consensus as of May-07-2019 10:22 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2018	1.21	1.05	▼(13.22 %)
FQ3 2018	0.06	(0.34)	NM
FQ4 2018	0.45	(0.63)	NM
FQ1 2019	1.06	1.58	▲49.06 %

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Call Participants

EXECUTIVES

Brian Charles Duperreault
President, CEO & Director

Elizabeth A. Werner
Head of Investor Relations and Vice President

Kevin Timothy Hogan
Executive VP and CEO of Life & Retirement

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

Peter Salvatore Zaffino
Executive VP, CEO of General Insurance & Global COO

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Presentation

Operator

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

Elizabeth A. Werner
Head of Investor Relations and Vice President

Good morning. And before we get started this morning, I'd like to remind you that today's presentation may contain forward-looking statements which are based on management's current expectations and are subject to uncertainty and changes in circumstances. Any forward-looking statements are not guarantees of future performance or events. Actual performance and events may differ, possibly materially, from such forward-looking statements. Factors that could cause this include the factors described in our first quarter 2019 Form 10-Q to be filed and our 2018 Form 10-K, under Management's Discussion and Analysis of Financial Condition and Results of Operations and under Risk Factors. AIG is not under any obligation and expressly disclaims any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

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

[Operator Instructions]. We're joined in the room today by members of senior management, including Brian Duperreault, President and CEO; Mark Lyons, CFO; Peter Zaffino, COO and CEO of General Insurance; and Kevin Hogan, CEO of Life and Retirement.

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

Brian Charles Duperreault
President, CEO & Director

Good morning and thank you for joining us today. Our first quarter results reflect the significant foundational work we've been undertaking since late 2017 and that we described to you in detail on our last earnings call in February. I'm pleased with our progress to date and remain confident it will continue through the remainder of the year.

Today, we will provide additional detail on our financial results as well as the progress we are making on a number of fronts in our General Insurance, Life and Retirement and Legacy segments. We are changing our usual lineup, so after my opening remarks, I'll be followed by Peter Zaffino, then Kevin Hogan, and Mark Lyons will close out our prepared comments before we move to Q&A.

In the first quarter, we achieved an adjusted after-tax EPS of $1.58 compared to $1.04 in the first quarter of last year. This reflects significant improvement in the core operations of General Insurance in addition to increased investment income due to the rebound in equity markets. Mark will provide more detail regarding the positive impact investment income had across our businesses, which represent $0.32 of our EPS improvement year-over-year.

In the first quarter, General Insurance achieved an underwriting profit of $179 million and a calendar year combined ratio of 97.4. First quarter accident year combined ratio, as adjusted, was 96.1. This quarter's underwriting profit represents a significant milestone for AIG and reflects the tremendous work undertaken by Peter and his leadership team over the last 18 months to radically improve underwriting fundamentals, overhaul our approach to reinsurance, dramatically reduce risk and volatility, onboard acquisitions and instill continuous expense discipline across General Insurance. We remain confident that GI will continue to improve its financial performance and deliver an underwriting profit for the full year 2019 as already evidenced by our first quarter results.

I'd like to comment briefly on AAL. As you know, over the last few quarters, I have been reluctant to talk about AAL because of the significant changes taking place in General Insurance and because our historical disclosure was not in line with our peers. I did say previously that you should assume AAL would be going down. Indeed it has. Our estimated 2019 AAL is 3.5%, a number I'm not too focused on as it will continue to change as our General Insurance strategy evolves and matures and because we view catastrophe management as a balance sheet topic as opposed to P&L.

As a result of the strategic actions we are taking, AIG is again recognized as a leader in the insurance market. Many of us attended RIMS last week and were gratified at the level of engagement and support we received from our clients and distribution partners.

The marketplace has taken note of our deliberate broad-based actions to recalibrate our book and aggressively reduce limits, risk and volatility. It is noteworthy that we are seeing corresponding improvements in almost every area, including retail, E&S, reinsurance. And these improvements are not just occurring in the United States, but also in a number of other countries. Peter will discuss this in more detail in his remarks.

I also want to briefly comment on the recent news about changes at Lloyd's. In my view, Lloyd's is taking actions that are necessary for it to regain its preeminent position in the industry. Our acquisition of Validus was driven in part by -- because of Talbot, a Lloyd's platform. So we're pleased to see Lloyd's embarking on a plan to restore its position in the marketplace.

Turning to Life and Retirement. This segment delivered another solid quarter with adjusted pretax income of $924 million and an adjusted ROE of 15%. We are reconfirming our guidance for L&R for the full year and continue to expect a low to mid-teens adjusted ROE. Kevin will provide more detail on L&R's first quarter in his remarks, including the impact of the rebound in equity markets.

With respect to our Legacy segment, we continue to make progress on our plan to deconsolidate and fully separate this business while ensuring we meet our commitments to our policyholders and regulators. As you saw in our press release, for consolidated AIG, we continue to expect to achieve a double-digit adjusted return on equity within 3 years. Our first quarter results demonstrate that our world-class team continues to make progress on our journey to restore AIG as the leading insurance company in the world.

With that, I will turn it over to Peter to expand on General Insurance.

Peter Salvatore Zaffino
Executive VP, CEO of General Insurance & Global COO

Thank you, Brian. Good morning, everyone. Today, I will share high-level financial information for General Insurance. I will expand on Brian's comments and highlight some of our accomplishments in the quarter, including notable financial progress that's being realized as a result of our underwriting strategy and the overall repositioning of our business. I will provide insight on our evolving reinsurance program, which has substantially reduced and accelerated volatility containment. And lastly, I will provide market observations based on our experience in the first quarter and make some brief comments as we look ahead to the rest of 2019.

As Brian noted, since the beginning of 2018, we've been undertaking significant foundational work in General Insurance around organizational structure, talent recruitment and improving underwriting capabilities while, at the same time, rapidly evolving our reinsurance program and exercising expense discipline. As a result, in the first quarter 2019, we achieved an accident year combined ratio, including actual CATs, of 98.8% or 96.1% as adjusted. The calendar year combined ratio was 97.4%. The accident year loss ratio, excluding CATs for the quarter, was 61.8%, a 130 basis point improvement year-over-year and a 210 basis point sequential improvement from fourth quarter 2018. In the first quarter, we experienced CAT losses of $175 million which were lower than a year ago.

The first quarter expense ratio of 34.3% represent a 230 basis point improvement year-over-year and a 60 basis point improvement from the fourth quarter of 2018. The general operating expense ratio was 12.5% for the first quarter, in line with the fourth quarter 2018 and 240 basis points lower than the first quarter of 2018. On a like-for-like basis, excluding the impact of acquisitions, operating expenses declined by approximately 18% year-over-year. These reductions were achieved while we remained committed to making investments in talent, business process and infrastructure to support our long-term profitable growth objectives. The acquisition ratio of 21.8% in the first quarter was in line with the prior year quarter and the fourth quarter 2018 and in line with our expectation given our current mix of business.

In addition to improved underwriting results, net investment income was favorable this quarter, coming in at $1.1 billion, bringing General Insurance's pretax operating income to $1.3 billion. Mark will provide more details on the General Insurance financial results in his prepared remarks.

As we stated over the last few quarters, to deliver improvement, particularly in our Commercial businesses, our primary area of focus was to create a framework that clearly defined the segments of business that we wanted to underwrite while leveraging the distinct value we believe AIG delivers in the insurance market. This framework enabled us to develop a cohesive risk appetite and to pivot to becoming a value-added partner to our brokers and clients based on our expertise, not just our capacity.

While it may sound simple and perhaps even repetitive, this was our major initiative in 2018. And when coupled with the strengthening of our core underwriting fundamentals, the changing mix of our business, the addition of Validus and Glatfelter, and the improvement we have driven in rate, we were able to craft a dramatically improved, comprehensive and strategic reinsurance program for 2019.

We remain committed to our journey of continuous improvement across General Insurance and are executing on changes to core businesses to shift our overall portfolio composition. Some highlights of actions we are taking that are driving improved operating and financial results include the following. In Lexington, for both Property and Casualty, we've narrowed our risk appetite and are focused on smaller and mid-market insureds and are committed to the wholesale distribution channel. We're also taking aggressive action on our renewal portfolio to align with our new risk appetite while exiting underperforming risks. As a result, we see momentum in both Property and Casualty. Property submissions are up over 20% year-over-year and we are achieving low to mid-teens rate improvement on the portfolio.

In our Casualty business, our submission count is up over 20% year-over-year as the marketplace has responded positively to our more tailored distribution strategy, enabling us to identify opportunities for profitable new business growth. In our Casualty portfolio, we're achieving low teens rate improvement. Overall, we're very pleased with the pace of the repositioning of our Lexington portfolio.

In Financial Lines, as I mentioned on last quarter's call, we've been focused on reducing gross primary limits and we remain very committed to deploying capacity for lead layers, while obtaining better balance by participating in excess layers.

We also have been disciplined on rate. For example, we've achieved in primary corporate D&O over 20% rate; and primary private D&O, over 15%; and in excess D&O, over 10%. In our North American book across primary U.S. D&O segments, aggregate limits were reduced by approximately 20% from the first quarter 2018 to the first quarter of 2019, and we also significantly reduced our policies above $10 million in lead layers by almost 35%.

The impact of our disciplined approach to risk selection and pricing is also reflected in our U.K. Financial Lines book, where our total limits across all layers of public D&O decreased nearly 35% year-over-year, and our [repeat] premium was only down slightly despite our underwriting actions.

In North America Property, we continued to take aggressive action to improve our portfolio. Our total gross limits in the first quarter declined 49% compared with the first quarter of 2018. Our average gross limit for risk management accounts declined 14%, our average deductible increased 25% and we've been able to achieve high-single digit rate increases on our in-force portfolio.

In addition to the portfolio actions, the acquisitions of Validus and Glatfelter directly align with our objective to improve our core business and diversify our portfolio. Both companies have delivered on their strong reputation for underwriting excellence and track records of generating underwriting profit.

On our year-end 2018 earnings call, we provided considerable detail on the substantial enhancements we're making to our reinsurance program. I do not intend to repeat that information today, however, I do want to stress that reinsurance continues to play a critical role in our overall strategy, and I'm very pleased with what we've accomplished. Together with the substantial improvements we're making to our underwriting approach and capabilities, our reinsurance program is contributing to our reduced risk profile and helping us reshape the better balance of our portfolio. The relationships we're building with reinsurers and the support we have received as we overhaul our reinsurance program is clear and strong industry endorsement of the work we're undertaking to improve our core business. We'll continue to refine and enhance our reinsurance program as our portfolio improves.

Let me briefly comment on rate. As I mentioned when I highlighted our progress in some businesses, we're seeing broad-based market support for premium rate increases across multiple lines at or better than our loss cost trends, which Mark will discuss in more detail. At a high level, we obtained rate increases of around 4% in our Commercial portfolio, including over 4% in North American Commercial lines, excluding Validus and Glatfelter; and almost 6% in U.K.; and 3% in Europe. While rate remains an important area of focus for us, we continue to believe that disciplined, methodical risk selection, coupled with a focus on terms and conditions, will be the primary drivers of sustained improved financial performance and profitability.

Turning to our reinsurance business. Validus Re had a very strong start to the year. In the first quarter, we did see market loss increases for Typhoon Jebi and other 2018 events. Despite these increases, Validus Re did not have any net adverse development in the quarter due to reinsurance treaties that absorbed these losses. Instead, Validus Re produced a $16 million favorable loss development in the first quarter.

Year-over-year, net premiums earned increased approximately 20% as we successfully executed on growth initiatives and diversified non-CAT classes. We're also seeing increased evidence of price discipline. Ceded commissions are broadly flat to slightly down; and on excess-of-loss placements, pricing is generally flat to modestly up.

While not part of our first quarter results, I do want to briefly comment on the April 1 Japanese renewals and the Florida's June 1 renewals. For Japan, rate increases range from 15% to 25% on loss-impacted CAT layers. Layers that were not impacted by catastrophes were priced flat to up 6%. We chose not increase our Japan exposures during this renewal season.

Shifting to Florida, the property reinsurance market had meaningfully underperformed over the last 2 years, and we believe it will undergo a meaningful price correction at June 1. This is driven by loss activity in 2017 and '18 and the need to modify loss cost to account for both increased frequency and severity.

Before closing, I'd be remiss if I did not acknowledge the efforts of the General Insurance leadership team and all of our colleagues around the world. I'm extremely proud of their hard work and accomplishments to date. Our improved results are due in large part to the team's tireless efforts, coupled with their incredible focus, dedication and courage to make material changes and difficult choices, all which have positioned us well for the remainder of 2019.

Looking ahead, we will continue to evolve our underwriting capabilities, streamline our operations, maintain expense control and invest in people and strategy that will enable us to further strengthen relationships with our clients and distribution partners. While there's still much work ahead of us, we remain laser-focused on our longer-term goal of achieving underwriting excellence and sustained profitability. Our momentum is palpable and we will continue our disciplined approach to decision making as we work to restore AIG as an industry leader.

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 $924 million for the quarter and adjusted return on equity of 15%. Adjusted pretax income increased by $32 million from the prior year quarter. The primary drivers of this increase were capital market-driven, impacting acquisition costs through lower deferred acquisition cost amortization of $46 million due to rising equity markets in the quarter, resulting in increased expected future fee income; and net investment income, reflecting both higher returns on fair value loss in securities of $46 million driven by tightening credit spreads, and higher accretion income of $26 million, reflecting interest rates declining in the quarter. Our earnings also benefited from nonrecurring expense items and reserve refinements in our International Life business of approximately $25 million.

These favorable impacts were partially offset by lower returns from alternative investments and lower fee and advisory income due to lower asset levels during the quarter driven by the market downturn at the end of last year. Prior year comparison also reflects a onetime bond payment recovery in the first quarter of 2018.

Our full year expectation for adjusted pretax income as well as our market assumptions have not changed. There could be some upside to our full year outlook should market conditions hold or improve. Keep in mind that declining equity markets and widening of credit spreads would accelerate deferred acquisition cost amortization and lower net investment income on fair value option securities, respectively. In addition, absent significant changes in the overall rate environment, our current expectation is that base net spreads will decline by approximately 0 to 2 basis points per quarter at least through the end of this year. From a statutory perspective, we expect to generate solid earnings and for our strong year-end risk-based capital levels to improve over year-end 2018.

Our team continues to do an outstanding job leveraging our broad product expertise and diversified distribution network to meet the evolving needs of our customers. In fact, LIMRA recently published 2018 results, and we were ranked as the #1 provider in total annuity sales, reflecting our capabilities and balance across annuity lines. This is the first time we have held this position since 2007.

Although we are pleased with the results, I want to stress that our strategy is not about market share, but instead to be in a position to compete at scale in each of our businesses. Our strong top line growth in the first quarter reflects the execution of our ongoing strategy. With favorable pricing conditions during the quarter, we significantly grew fixed and indexed annuity sales.

We also increased Group Retirement deposits, grew International Life sales and closed a large pension risk transfer transaction in the quarter. The pension risk transfer deal which we recently announced represented approximately $750 million of pension obligations. As with all such transactions, earnings will emerge over time and the earnings impact during the first quarter was immaterial. We remain well positioned across our businesses to serve a growing market, enabling us to continue to deploy capital at or above our targeted economic returns while recognizing we will incur some additional new business expenses associated with such growth.

I will now talk briefly about the results for each of the businesses. For Individual Retirement, premiums and deposits grew by 30%. With these strong sales levels, we achieved positive net flows for the first time since the third quarter of 2016.

Net flows for Retail Mutual Funds continued to be challenged. Retail Mutual Funds, which is a comparatively small part of our earnings, is a defensibly positioned portfolio that is countercyclical to our individual annuities and may continue to face headwinds in the current environment.

Assets under management and related fee income decreased driven by lower asset levels following the equity market decline in the fourth quarter. Net investment income increased, primarily due to the market-driven factors mentioned earlier.

For Group Retirement, premiums and deposits grew by approximately 11% for the quarter with higher group acquisitions, in-plan annuity contributions and individual product sales. Surrenders and other withdrawals increased, primarily driven by the loss of one large group due to the plan sponsor reducing the number of providers offered in its plan and higher individual surrenders and other withdrawals. We expect higher surrenders and other withdrawals to continue to negatively impact net flows, but it is 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 net flows for a period of time, we've continued to produce solid earnings for this business, and assets under administration are at the same level as the first quarter of 2018.

After adjusting for accretion income and unusual items, new money rates are still below portfolio yields across our retirement portfolios, resulting in reduced but still attractive spreads in many products. Also in a rising rate environment, it may be appropriate for us to increase crediting rates for certain of our in-force business.

For our Life Insurance business, total premiums and deposits and sales increased for the quarter driven by strong sales growth in our U.K. individual Protection product line as well as the addition of Group Protection sales with the acquisition of Ellipse. Our U.S. Life sales declined as we deemphasized guaranteed universal life sales in the current interest rate environment. For our U.S. Life business, we continue to make progress on making the necessary infrastructure changes to completely separate our operating model from Fortitude Re and to pursue possible transactions that will lead to deconsolidation in the future. Adjusted pretax income increased due to overall mortality experience which was within pricing expectations, positive reserve and reinsurance refinements and lower operating expenses and commissions.

Lastly, for Institutional Markets, as I mentioned earlier, we executed a large pension risk transfer transaction in the quarter at attractive economic, statutory and accounting returns. The market pipeline for pension risk transfer transactions over the next 12 to 18 months continues to be robust. We also executed a GIC issuance of $250 million in the quarter. 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.

To close, we remain committed to our ongoing strategy to leverage our broad product expertise and distribution footprint and deploy capital to the most attractive opportunities, which we believe positions us well to help meet the 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

Thank you, Kevin, and good morning, all. So getting right into it, AIG's adjusted after-tax earnings per share was $1.58 for the quarter compared to $1.04 per share in the corresponding quarter of 2018. In dollar terms, AIG had $1.85 billion of adjusted pretax income and $1.39 billion of adjusted after-tax income. Book value per share, excluding AOCI and the DTA, increased $0.52 per share or nearly 1% as compared to the fourth quarter of 2018. As respect to adjusted return on common equity, or ROCE, which also excludes AOCI and DTA, AIG returned an annualized 11.6% for the quarter and the segments achieved the following returns on attributed equity: General Insurance achieved a 14% return; Life and Retirement, a 15% return; Legacy had a 4.4% annualized return. AIG is now using the term return on common equity because this quarter, we introduced some preferred into our capital structure.

As respect net investment income, or NII, it should be noted that due to the market's rebounding from poor fourth quarter 2018 performance, this quarter had outsized gains, the likes of which should not be viewed as recurrent across the next 3 quarters in 2019. As a result, I will begin my comments about NII across the company so I don't need to do so within each segment.

Net investment income for the first quarter was $3.72 billion on an adjusted pretax income basis and $3.88 billion on a GAAP basis compared to $2.81 billion and $2.75 billion, respectively, in the sequential fourth quarter of 2018. This material improvement was predominantly due to the improving equity markets, tighter credit spreads and improved alternative investment performance, but was also partially due to changes in accounting presentation by AIG effective in the quarter in 2 ways.

Firstly, AIG now recognizes changes in the fair value of equity securities below the line, which is much more consistent with the vast majority of our peers. The impact of this geography change for the quarter was a reduction in net investment income of $79 million.

Secondly, we reclassed NII that had heretofore been reported in the other income line of noninsurance subsidiary into the official net investment income line. The impact of this change was a $116 million increase to the NII line this quarter, and it is hoped that this reclassification now removes a consistent source of confusion amongst the investor and analyst communities. It's important to note that this reclassification did not alter adjusted pretax earnings at all, simply geography. But I also want to point you to Pages 12 and 13 of the financial supplement to see the historical quarterly impact of these 2 reclassifications.

When assessing AIG's investment portfolio volatility and resultant NII, we believe it's helpful to provide a summarized view somewhat akin to the way our Chief Investment Officer thinks about the portfolio. This view looks at the portfolio as 2 broad asset classes: Assets that are inherently fairly predictable and those that are inherent fairly volatile. The fairly predictable class is comprised of available-for-sale fixed maturity securities, mortgages and other loans and short-term investments, which total about $293 billion carrying value of assets or approximately 91% of the portfolio. The other $29 billion of carrying-value assets are fairly volatile and are comprised of fair value option securities, hedge funds, private equity, real estate and miscellaneous other investments.

The fairly predictable assets provide about $12.5 billion of gross NII on an annual basis or about a 4.25% yield, whereas the fairly volatile assets have yielded NII of approximately 5.8% over the last 5 quarters, or what you can see in this financial supplement, ranging from about 2% to over 9%. Therefore, just using the last 5 quarters as a simple volatility measure, the NII from the fairly volatile assets could range from nearly $600 million to $2.6 billion annually. One must also reflect that there are annual investment expenses of roughly $450 million that must be netted against this.

The volatility shown in the fourth quarter of 2018 and in the first quarter of 2019 implies that an overreaction to the fourth quarter's lower net investment income wasn't warranted, and neither is overreaction to the higher net investment income this quarter. It's nearly impossible to accurately forecast market performance over the balance of the year and the simple framework we've just provided shows the difficulty of predicting short-term market performance.

It's also important to recall that in the fourth quarter, due to materiality, we recorded an $86 million pretax hit to income associated with hedge funds and Japanese equity marks usually recorded on a 1-month lag. For the first quarter of 2019 forward, we are now recognizing hedge funds without any lag at all. So the first quarter did indeed reflect a full 3 months of results, and therefore, all current and future hedge fund commentary will center on that quarter's activities rather than containing 1 month of the prior quarter.

The only remaining lagged investment recognition is for private equity holdings, which has a full one-quarter lag. Nevertheless, the fourth quarter lagged results booked entirely in AIG's first quarter contributed positive net investment income, highlighting AIG's positive selection benefit versus any broad applicable market index.

Turning to General Insurance, and as previously noted, the segment produced both a calendar quarter and accident quarter underwriting profit with an actual CAT ratio of 2.7% this quarter versus 5.7% the first quarter of 2018.

The North America segment of General Insurance produced a 98% accident quarter, excluding CATs, combined ratio, with the North America Commercial lines component producing a 96.4% accident quarter, ex CATs, which represents a 10.7 combined ratio point improvement over the first quarter of 2018. Although 1.8 points of this was due to expense ratio improvement, the 8.9 points of accident quarter loss ratio improvement can be largely attributed to the gross underwriting changes beginning to earn-in, along with the material reinsurance protection that Peter highlighted.

The North American Personal lines operation worsened this quarter, primarily due to increased frequency in the attritional loss ratio. The International segment of General Insurance produced a 94.5% accident quarter combined ratio, ex CATs, versus 96.8% comparable ratio in the first quarter of 2018. Both the Commercial and the Personal line segments contributed improvement, predominantly on the expense ratio side.

Looking at the quarter from an AAL perspective. The 2019 full year AAL is estimated to be 3.5%. And as Brian noted in his remarks, the combination of gross underwriting changes, most notably the reduction in gross fire and associated peril limits, along with purposeful reductions in exposures, was complemented with a radically altered reinsurance program that provides critical and noncritical CAT protection within many of the [peril restructures], along with a CAT program that provides material vertical and horizontal, regional and global protection, which is also further enhanced with specific carve-out CAT programs for our client -- our private client group in the United States.

The combination of these front- and back-end actions has provided material volatility containment at all upper-return period levels, leading to a reduced AAL. My view of the first quarter's accident year result is therefore a 99.6% combined ratio inclusive of AAL and a 98.8% accident quarter combined ratio inclusive of actual CATs. As a result, we will be speaking of CATs in the future only in terms of risk tolerance along with our measurement against that tolerance by various return periods and not focusing on AAL.

Now shifting to the business mix in General Insurance. The overall quarter-over-quarter net written premium reduced by 2.3%, but some areas had large swings, both up and down, as can be seen in the financial supplement. However, at a high level, and excluding the impact of Validus and Glatfelter and adjusting for the Fuji 2-month lag elimination in the first quarter of 2018, net written premiums decreased approximately 17% after additionally adjusting for foreign exchange. Approximately 1/3 of the 17% reduction is associated with direct underwriting action and about 2/3 can be largely attributed to increased reinsurance premiums.

With respect to general operating expenses, or GOE, the reduction was $237 million quarter-over-quarter when adjusting for Validus and Glatfelter since neither was a part of AIG in the first quarter 2018. This represents, as Peter noted, a 240 basis point improvement in the GOE ratio quarter-over-quarter. As we stated on previous calls, in General Insurance and across the company more broadly, we continue to undertake a comprehensive review of workflows and process improvement opportunities as well as overall expense levels.

Turning to prior year development. The quarter saw $74 million of net favorable development, with $72 million of this favorable development stemming from General Insurance and $2 million favorable from the Legacy operations. There were no reserve deep dives into any specific line of business this quarter, but the actual versus expected review was done comprehensively across all global operations. The result was that most areas had loss emergence either better or in line with expectation, so no material reserve changes were deemed necessary.

The $74 million in net favorable development is mostly driven by the amortization associated with the deferred gain of the adverse development cover, namely $58 million, and the remaining $16 million of General Insurance net favorable development was scattered across many lines and regions. Additionally, with the revised underwriting and low per-risk attachment reinsurance strategy, our historical reporting on net severe losses no longer makes sense. So from now on, we'll be commenting on attritional net losses only.

Peter commented on General Insurance's achieved rate increases for the quarter, and I'd like to additionally point out that for North American Commercial in particular, the rate increases have been accelerating and the March increase alone averaged over 7%, which is clearly in excess of loss trend and thereby providing additional market expansion. Similarly, our monitoring of portfolio composition clearly shows the superior rate adequacy of new business relative to that of lost business as well as improvements to the renewal book's adequacy. These shifts in overall portfolio rate adequacy provide additional lift for continued improved performance.

Turning to the Life and Retirement segment. Adjusted pretax income of $924 million represents a $32 million increase over the first quarter of 2018 and a $301 million increase sequentially over the fourth quarter of 2018. These results, as Kevin mentioned, translates to a 15% annualized return on average attributed common equity for the quarter. All units reported increases in adjusted pretax income sequentially relative to the fourth quarter of last year. Individual Retirement had stronger investment income and positive net flows for the quarter, but with base net investment spreads that are expected to experience a downward drift that Kevin highlighted.

Group Retirement net flows were negative due to the slightly lower sequential premiums and deposits and sequentially higher surrenders and withdrawals. Group Retirement business, like others in the industry, is exposed to client consolidations via mergers or by the reduction of providers offered in plans. The quarter saw favorable results from Life International operations, and Institutional Markets, for the second quarter in a row, was successful in the pension risk transfer space.

Turning to Legacy. Adjusted pretax income was up $262 million sequentially to the fourth quarter of last year, but such comparisons are not overly meaningful given the nonrecurring loss recognition charge taken on certain cancer and disability A&H blocks last quarter. However, the quarter's $89 million of adjusted after-tax income translates into a 4.4% annualized return on attributed common equity. But given that the quarter experienced the already discussed investment rebound as well, our view of a 2% to 3% return for the full 2019 year remains valid.

As respect to tax, the effective tax rate is 22.5% for the quarter, excluding discrete items, applicable to adjusted pretax income. Including discrete items, the tax rate was 22.9%. As you know, the effective tax rate is updated each quarter using actual results and then supplemented by reforecasting the remaining quarters. And as always, the tax rate is heavily influenced each quarter by the geographic distribution of income by tax jurisdiction.

Moving on to capital actions. We issued $1.1 billion of securities in the first quarter, split between $600 million of 10-year debt with a 4.25% coupon and $500 million of non-cumulative preferred stock with a 5.85% dividend. We did not repurchase any shares in the quarter, so our Board authorization remains at $2 billion.

With that, I'll turn it back over to Brian.

Brian Charles Duperreault
President, CEO & Director
Well, thank you, Mark. I think we can go to questions and answers. So first question, please.

Question and Answer

Operator

[Operator Instructions] Our first question now comes from Elyse Greenspan from Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question, going back to some of your comments on this call and on prior calls, you made reference of all these underwriting changes and how they're beginning to earn-in. I guess I'd like to get a better sense of the forward momentum. I know on last quarter's call, you guys had mentioned that the prior management team's go-big strategy at AIG had resulted in multi-year policies that are still on your books in 2019. So could you just give us a sense of the running off of those policies and how that could benefit to incremental underlying margin improvement as we go through the balance of 2019 and into 2020?

Brian Charles Duperreault
President, CEO & Director

Okay, Elyse, yes. Well, Peter, I think you should take the...

Peter Salvatore Zaffino
Executive VP, CEO of General Insurance & Global COO

Okay. Elyse, thanks for the question. There were a meaningful amount of long-term deals done in the core property book historically. And when we had announced that we're changing underwriting guidelines, that was something we did not want to do going forward. But as you mentioned, it takes a little bit of time to earn-out. So we should see a meaningful reduction in long-term deals by the back half of 2019. So I think as we -- back half of '19, as we enter 2020, we'll have cut our long-term deals in half and we'll start to see the majority of the portfolio increasing in terms of just annual 12-month deals.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. Great. And then my second question. You guys referenced strong prices it seems, like you guys saw in March, really improving from the trend. I guess, could you just give us a sense on your forward view on pricing? And then as we think about pricing versus trend, can you give us -- help give us a sense of when that could really start to earn-in and be beneficial to the margins you saw in the first quarter?

Brian Charles Duperreault
President, CEO & Director

Yes. I'm going to talk about -- a little bit about this and let Peter talk about the pricing itself. I just want to point out that, yes, this pricing, it's warranted, needed. The old industry is recognizing that. In our own case, we had other things we had to do, too. So there's more things going on than just getting price on the portfolio. And that is, Peter said, the selection process, getting the right risks on board, positioning ourselves properly in their program attachment point, putting the right limit out, et cetera. So a lot of that is causing the improvement on our portfolio. Pricing is a component of it, an important component, but a component. Peter, do you want to go a little bit into the pricing?

Peter Salvatore Zaffino
Executive VP, CEO of General Insurance & Global COO

Sure. I think we outlined a lot of it in the prepared remarks. I think what's happening, which is little bit different, is that we're seeing it across the board, it's in multiple lines. I mean, certainly, Property has underperformed the most. And so whether it's CAT capacity, attritional losses on how capacity has been deployed, we're seeing rate within the E&S as well as the admitted markets. So that's, I think, going to be consistent throughout the rest of the year. We've seen it in Financial Lines. I think as we can participate in many lines of business and then in many parts of the program, we're seeing that momentum, as Mark mentioned in his prepared remarks, pick up in March. And we would expect that to continue throughout the year. So it's a very orderly, meaning it's one that is not just spiking in one line. It's across multiple lines and in a lot of parts of the world. So I think this is something that, hard to predict how long it lasts, but we're going to lead with, again, risk selection, but also making sure we're getting paid appropriately for the limits that we put out and the risk that we're underwriting.

Brian Charles Duperreault
President, CEO & Director

Yes. And this pricing isn't just a first quarter phenomenon. It's been building through '18. And so it'll bleed in as we earn these premiums. And as Mark pointed out, there seems to be some acceleration.

Operator

Our next question comes from Yaron Kinar from Goldman Sachs.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

So 2 questions. First, I think in the press release, Brian, you talk about an expectation that this year will be profitable on both the calendar year and accident year basis. I'm just curious, is that with catastrophes that your comments are based on?

Brian Charles Duperreault
President, CEO & Director

Well, with catastrophes, I can't tell you whether we're going to have a large catastrophe year or a small catastrophe year. I mean, we had this thing called AAL, which I did insert into the number. And as I said, it's 3.5%. I don't really want to talk about it after that. So I mean, look, I think over a long period of time, there will be years where we have catastrophes, years we don't. But on the average, we expect to make an underwriting profit, and I expect to make an underwriting profit this year. But I can't predict whether it's going to be a big CAT year or not. But I mean, on some kind of an average basis, certainly that is our belief, a very strong belief.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay. So basically, this comment is without using AAL, and so assuming some normalized catastrophe load?

Brian Charles Duperreault
President, CEO & Director

When you put an AAL in, I mean -- I said we put an AAL in the first quarter and it was -- they wrote some tickets under 100%. You put an AAL in for the whole year, it will be -- I would say we believe it'll be under 100%, but I can't tell you the actual CATs, that's my point.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay. Appreciate it. And then my second question is on NII. So Mark, if I take the math with the sum of the parts that you laid out, I get to about $13.7 billion of NII for the year. And I think that's a little bit above the $13 billion guidance that management had previously offered. So how should we think of NII kind of on a normalized basis from here?

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

Well, first off, some teachers would give you partial credit and some teachers just are binary and say yes or no. So -- but I'll give you partial credit on that. So you've reflected the $450 million of investment and expenses as a gross-to-net, but you have to recognize that the original guidance of $13 billion did not include the reclass. And depending on whether you look at the last quarter, where the reclass was $116 million; or you look at a longer period of time, where it's closer to $115 million, which would be $600 million, I would get closer to $13.2 billion, $13.3 billion, if that's helpful.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Yes. But you also had a reclass of the equity fair value adjustment, right? So...

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

That's right, which was $79 million in the quarter.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay. So you get the $13.2 billion, $13.3 billion with both reclasses?

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

Yes. If you reflect that, you'll be approximately there.

Operator

The next question is from Paul Newsome from Sandler O'Neill.

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

I was hoping you could talk a little bit about CAT load volatility just on a normalized basis. There's just been so much change with your business mix and reinsurance and the like. And I guess I traditionally think of insurance companies as sort of having their toughest CAT quarter in the third, and second sort of the second-worst, and maybe first and second are about the same. But do you think that AIG is going to follow sort of the traditional pattern? Or with all these changes, do you think there will be a difference in your normal CAT load volatility quarter-to-quarter?

Brian Charles Duperreault
President, CEO & Director

I would love to give this to somebody else. So let me try to start with. And so I think there's -- yes, there's an inherent seasonality to CATs, I mean, because of the storm seasons, which are third and fourth quarter. Quakes can happen any time. I mean, we've had weather in the first quarter with storm losses -- winter storm losses, et cetera, but yes, by and large, I'd say the first half would be a little lighter than the second half. That's just traditional. I don't think that's changing now. But I don't -- first of all, I don't really want to talk about AALs anymore, but anyway. We think about it as an annual number because you have -- really have to think of it at least on an annual basis. Peter, do you want to say something?

Peter Salvatore Zaffino
Executive VP, CEO of General Insurance & Global COO

The only thing I would add, Brian, because the question was also around volatility and we use that word a lot in our scripts. But in addition to putting together a much more comprehensive program and in addition to making it an aggregate, our standard deviation and expected volatility around our different return periods has decreased by 50%. So while it's not certain, the expected value around, whether it's AALs or PMLs, has reduced significantly in terms of what we think is going to happen. So that is something that, through the entire reinsurance design, has been very beneficial and gives us more confidence.

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

And one thing I would add into that -- hey, it's a good question, Paul -- is in my prepared remarks, I tried to show that per risk is also helpful in that regard, and that's the CAT programs that were put in place, let alone the carve-outs or PCG, gives materially better vertical and horizontal protection, regionally and globally. So I think that helps with the containment. And I would ask you to not forget one thing we talked about last quarter, which was the way the gross underwriting changes earn-in is -- because they started earlier, is one view, but the reinsurance mostly attached in the latter half of 2018. Some of that was risk attaching, some of that inures to the benefit of the CAT program, which is loss occurring. But the point is, we'll get increasing protection and volatility reduction as we go from quarter to quarter to quarter in 2019.

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

Okay. And then any updates on the capital management thoughts? There weren't any buybacks this quarter but you did raise some capital. Just wanted to see if there was any additional thoughts you got there.

Brian Charles Duperreault
President, CEO & Director

No. Look, we were largely blacked out the first quarter, so -- because of those offerings you mentioned. So look, I think we continue to look at it. My philosophy hasn't changed. I think it's an appropriate capital management tool. And as we go through the year, we'll look at how we want to use that capital. And so no changes there.

Operator

This question is from Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I was interested in understanding about the timing of the reinsurance purchasing for the remainder of the year. You had said that about 2/3 of the reduction, I guess, in the sum of AIG's and Validus' 1Q '18 premium year-over-year was related to reinsurance buying. Are you buying more reinsurance, which would have a similar effect in the quarters to come? Or is the first quarter the big buy quarter? And then how does that affect expense ratio as we go forward?

Brian Charles Duperreault
President, CEO & Director

Peter?

Peter Salvatore Zaffino
Executive VP, CEO of General Insurance & Global COO

Thanks, Josh. We have -- the only probably material impact that we foresee as of now is how the sort of casualty quota-share will earn through the year for the U.S. because that's a big session and one that just commenced on a risk-attachment basis in the first quarter. So that was the most material. I don't believe that we will see any other material purchases on property. So we've done a lot on a per risk, as Mark mentioned, on the aggregate. We have done some facultative purchasing to make sure that we take out the volatility of our long-term deals on Property. And I don't think that -- as we look to the remaining part of the year, we have thought about the impact of reinsurance and do not believe it will impact our expense ratio as we head into the second and third quarters.

Operator

Our next question is from Ryan Tunis from Autonomous Research.

Ryan James Tunis
Autonomous Research LLP

A question for Peter, and maybe Mark can help. But severe losses, I know you're not disclosing those anymore, but could you give us some idea of how those ran here versus, I think, at $125 million was the expected level last year.

And also in terms of the GOE run rate, it was $839 million this quarter in General Insurance, which is down about $50 million from 4Q levels. Is that, the $839 million number a pretty good one to use over to the remainder of the year, do you think?

Peter Salvatore Zaffino
Executive VP, CEO of General Insurance & Global COO

So let me comment on severes, and I will turn over to Mark. But in the quarter, we had less gross activity than if you looked at our multiple quarter average. But I think the bigger issue was just in terms of how we addressed the Property per risk, and just buying down and taking out volatility, in addition to one of the areas of our business which had a little bit more frequency on severity. We ended up working through a quota-share to mitigate a lot of the volatility. So I think it was -- one was the gross, but more importantly, is what we've done to protect volatility through reinsurance. Mark, anything you want to add?

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

Yes. I would just say on the severes, without getting into any specifics, it was a very light view of it. So it's -- which is yet another reason. But the front-end underwriting changes Peter talked about, the reinsurance changes, it just changes the game. But there was nothing adverse on severes.

Brian Charles Duperreault
President, CEO & Director

Do you want to comment on the GOE?

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

The GOE, because the $839 million you're quoting incorporates Validus, so we intend to do quarter-over-quarter that excludes that to get apples-to-apples. So it's probably a more realistic one, but I think you should be thinking more in terms of ratio rather than on the dollar sense. We've had 2 consecutive quarters of GOE being 12.5% of earned premium, and that can move a little bit as a function of miscellaneous items and accounting that could affect earned premium and things like that. But that's probably the preferred way to look at it.

Ryan James Tunis
Autonomous Research LLP

Okay. And then I just had a follow-up on -- I mean, we hit on CAT volatility, but curious on how you guys are thinking about volatility within the attritional loss ratio. So if you have a view of what the central tendency is, like say, the 63.1% you think is a good run rate. How many points away from that is -- do you think one standard deviation, it could just be explained by adverse luck? Is it 1 point now? Is it 2 points? Because, like, at companies like Travelers, we're used to it being -- less than a point per quarter could be just explained by adverse activity. Are we at that point yet? Or could we still see 2- or 3-point swings off of what you think you're really running at?

Brian Charles Duperreault
President, CEO & Director

I think that's Mark.

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

So a couple of thoughts come to mind. One, I don't really look at it that way. I suppose I could go back. But we have a massively diverse global geographic presence and different characteristics. The company you mentioned is much more of a frequency-driven company and therefore more predictive. We have a lot of -- we're changing that mix to be much more mid and smaller, but the in-force book still has a lot of severity characteristics, both frequency and high severity characteristics. So I would say there's a fair amount. The reinsurance is going to contain that because you asked a net loss ratio question. So it's going to contain that more, but I would expect it to be wider than Travelers.

Brian Charles Duperreault
President, CEO & Director

Yes, I think it's fair.

Operator

Next question is from Andrew Kligerman from Crédit Suisse.

Andrew Scott Kligerman
Crédit Suisse AG, Research Division

Great. Just want to follow up on Paul's question about the buybacks. And understand you were in blackout period. But given your debt-to-capital is pretty close to 30%, is it fair to assume that you probably don't want to do much by way of buyback for the balance of the year?

Brian Charles Duperreault
President, CEO & Director

I don't want to predict anything here. Do I want to, don't I want to? I mean, I think we'll go through it quarter-by-quarter and really understand uses of that capital. So we have a buyback authorization in place, continues to be there to be used. I don't want to comment any more than that. [Well said], Andy.

Andrew Scott Kligerman
Crédit Suisse AG, Research Division

Okay. All right. And then just with regard to the Personal line. So I know Mark earlier was talking about 2/3 of the normal -- when you take out the acquisitions, et cetera, premium -- or net written premium were down 17%. 2/3 due to the reinsurance. And now just looking at the Personal lines, North America down 6%, International down 12%. Could you give us a sense of what the reinsurance component of that decline was?

And also you mentioned in the release A&H premiums were lower. Is there some competitive situation going on with that that's putting pressure on A&H?

Brian Charles Duperreault
President, CEO & Director

Peter?

Peter Salvatore Zaffino
Executive VP, CEO of General Insurance & Global COO

So the Personal Insurance in the United States, our travel book, our warranty book came in exactly where we had thought it would in terms of a combined ratio for the quarter. So we're really talking more about the high-net-worth book. And looking at the composition of that book, we not only had that contribute from the sort of global aggregate where we lowered our attachment point, we also bought more per risk. We also bought a specific CAT program that has different attachment points depending on peak zones for our high-net-worth book that we think will dampen volatility and also allow us, as we want, to reposition certain peak zones of the portfolio and accelerate our underwriting. We just hired a terrific individual in Kathleen Zortman, who has decades of experience in driving high-net-worth portfolios. We're really excited she's joining us. And that will happen in the second quarter, and we'll begin to accelerate like we have on other portions of the portfolio and improvement in terms of its footprint. And the reinsurance is, I think, very responsible and it will respond well throughout the year, depending on what happens in terms of CATs.

Andrew Scott Kligerman
Crédit Suisse AG, Research Division

And so the question was...

Peter Salvatore Zaffino
Executive VP, CEO of General Insurance & Global COO

So on the A&H, we just don't -- you shouldn't read into anything on the A&H. It's a terrific portfolio, performs very well in terms of its combined ratio. And it's an area where Brian and I very much want to grow our book. And we should take a longer-term view, but it's an area where we think we'll have growth over the long term.

Brian Charles Duperreault
President, CEO & Director

And we've used up our [risk]...

Peter Salvatore Zaffino
Executive VP, CEO of General Insurance & Global COO

We just have named a global leader, Ed Levin. And so he's joined us and we have strategy in place and beginning to accelerate our growth. It'll take some time, but really excited about that portfolio and what it can mean for us long term.

Brian Charles Duperreault
President, CEO & Director

Just one last question and then we'll wrap it up. So operator, the last question, please.

Operator

Certainly. And this comes from Tom Gallagher from Evercore.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

First question on P&C. You had big growth in Specialty Risk in terms of net premium written. Just curious what kind of combined ratio that's being booked at. Is that going to add meaningfully to underwriting improvement as that earns in? And can you just provide a little color, what -- kind of what drove that significant growth?

Peter Salvatore Zaffino
Executive VP, CEO of General Insurance & Global COO

It was mostly the acquisition. We had Talbot and CRS, which is the crop, and so that's in the Specialty classes. Look, Talbot's a terrific syndicate and has a very balanced portfolio with marine, Specialty classes, including energy, political risk and political violence. And we've been working very hard to determine what's going to fit within AIG, what's going to fit within the syndicate and do believe that, that business will perform well over the short, medium and long term and will contribute, like Validus Re has, to our overall improvement in combined ratio. But it's very good. And on a calendar year basis, it performed quite well in the quarter.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got you. And then just a follow-up on net investment income, Mark. I was following the stable asset class returns versus the more volatile ones. And just looking at the $29 billion that you characterized as more volatile, if I'm looking at your guide for full year NII, I think that only would imply something like a 3% return on that $29 billion carrying-value portfolio. And you have, I think, plenty of higher-returning asset classes in there like private equity and the like. First off, is that right? And secondly, does that imply your

$13.2 billion NII guidance is just conservatively assuming returns on that portfolio? Can you provide some color on that?

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

Well, first off, Tom, the first question would be what period of time should you assess volatility? I purposely looked at something that worked for this [fin set], which was current and 4 prior quarters, so 5 quarters. That particular one averaged 5.8% over that period with a swing of 2% to 9%, which shows you some of that volatility. So that's implying like another $1.7 billion on a 5.8% basis, which so the $12.5 billion takes you to $14.2 billion. You got to take out the $450 million annually for investment expenses, and then the reclass impact that wouldn't have been in there in the original guidance of $13 billion even. And that composite gets you down to the $13.2 billion, $13.3 billion. But I think what -- the question you have to answer for yourself is, what's the proper volatility measurement? I just gave you an example of one.

Brian Charles Duperreault
President, CEO & Director

Okay. Thank you, everybody. Listen, before -- thanks, Tom.

So look, before we end the call, I want to thank everyone who dialed in for your remarks. And I am approaching my 2-year anniversary at AIG and I couldn't be prouder of what we're accomplishing at this great company. And I'm grateful for the tremendous support we are receiving across the industry. And I want to thank all our colleagues at AIG for their hard work, dedication and resiliency. We still have a lot of work ahead of us, but our first quarter results demonstrate we're on the right path. So thank you very much. Have a great day.

Operator
Ladies and gentlemen, that now concludes today's conference call. Thank you for your participation. You may now disconnect.