S&P Capital IQ

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American International Group, Inc. NYSE:AIG

FQ3 2013 Earnings Call Transcripts

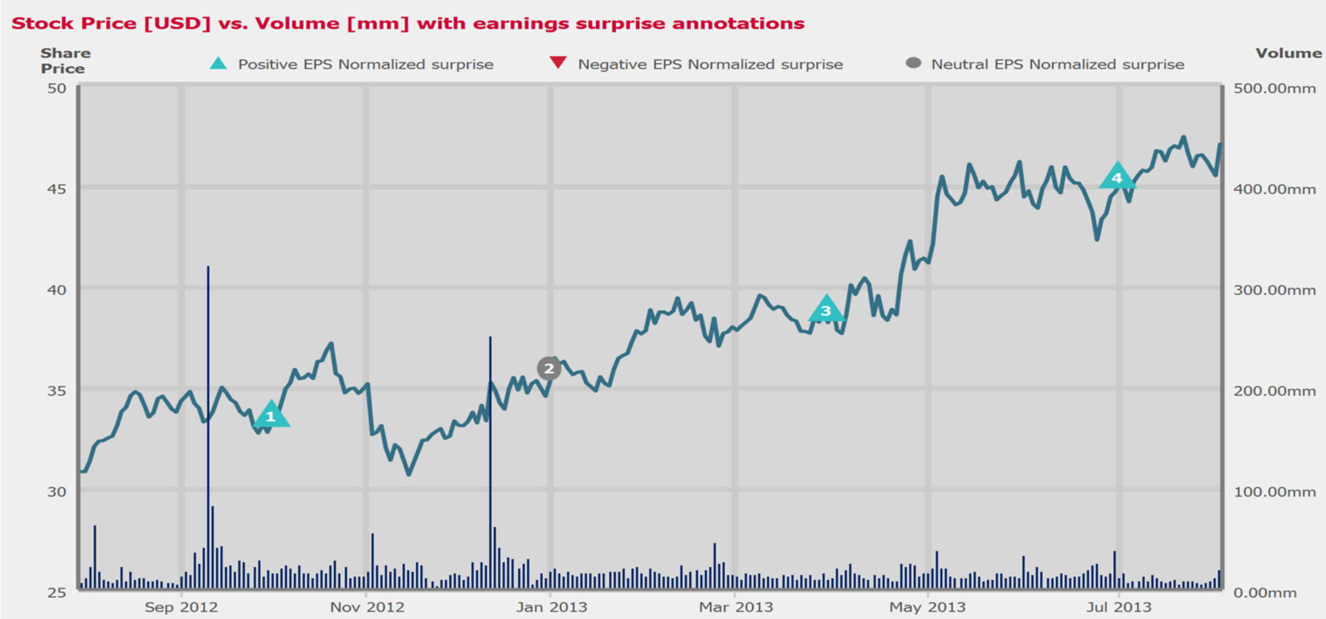
Friday, November 01, 2013 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2013-			-FQ4 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.96	0.96	0.00	0.93	4.31	4.31
Revenue (mm)	8644.83	8427.00	(2.52 %)	8602.14	34012.17	39545.67

Currency: USD

Consensus as of Nov-01-2013 10:56 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2012	0.89	1.00	1 12.36 %
FQ4 2012	(0.07)	0.20	NM
FQ1 2013	0.88	1.34	2 52.27 %
FQ2 2013	0.86	1.12	3 30.23 %

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Presentation

Operator

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

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, and good morning, everyone. Welcome to AIG's discussion of third quarter 2013 results. Speaking today will be: Bob Benmosche, President and CEO; David Herzog, Chief Financial Officer; Peter Hancock, CEO of AIG Property Casualty; and Jay Wintrob, CEO of AIG Life and Retirement. Other members of senior management are also in the room and will be available for Q&A at the end of the period.

Before we get started, 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 third quarter and second quarter 2013 Form 10-Qs and our 2012 Form 10-K under Management's Discussion & Analysis and under Risk Factors. AIG is not under any obligation and expressly disclaims any obligation to update any forward-looking statements whether as a result of new information, future events or otherwise. Today's presentation may contain non-GAAP financial measures. The reconciliation of such measures to the most comparable GAAP figures is included in our financial supplement, which is available on AIG's website, www.aig.com.

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

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Thanks, Liz, and good morning, everybody. And this is another solid quarter for AIG, and we clearly have said we're going to work on making sure that you see consistent and improving earnings of the company over time. And I think you see that in our operating numbers for the insurance companies in particular.

I'd also like to welcome Kevin Hogan. As you know, we've held the position of the consumer group open under Peter Hancock. We have waited for Kevin to return, 24-year veteran of AIG, having run much of the consumer businesses over that career. And we're pleased to have him back. So Kevin, welcome back, and we're looking forward to you talking to our investors next quarter on the progress you're making on the consumer side.

Before we get into the numbers, first, about ILFC. We continue to work with the consortium that has been working with us over the almost past year. We still feel that while they're making slow progress, they are making progress. But this quarter, accounting suggests that we have to think about whether this continue to be a discontinued op and some other accounting rules. So we're really thinking hard about if we can't get this transaction closed this quarter, then we may want to commit into a path of IPO for next year and not continue to carry it the way we're carrying it on our book. So that's a decision we hope to make in this fourth quarter. However, we still feel that there's a good chance that this transaction can close as is.

On the aspirational goal comment that I made yesterday and we want to talk about today, clearly when we went and did our re-IPO in May of '11, there was some serious concern in the marketplace. Could AIG survive and continue to grow and thrive? And we put together some key points that we felt we needed to all work towards to give you the confidence that we can, in fact, return to a very strong company. And we have been committed to those aspirational goals, and we are still committed to those aspirational goals. And this entire company is working towards achieving that. However, as we head closer to 2015, we feel that comments going forward are more like guidance rather than a direction that we're all working towards. And so we are going to stop making comments on that progress towards the aspirational goals. And we are still, as I said, committed to them, but we're not sure whether we'll get them done by 2015. And so once we get closer and beginning to comment on it, that's where the theory of guidance comes into play. So I do want you to understand that we are committed to them. We're working hard to get there, and we'll get there as quickly as we can.

So let me move to Page 3 and talk about capital management and liquidity. You see our liquidity continues to be strong. We're continuing to focus on our coverage ratio, which is what we said we would do in terms of buying back debt. But we're also issuing debt where it makes sense for the future and looking at our future trendlines in terms of when debt is coming due. We also declared a dividend for the quarter, so we're back doing that. And in the middle of the quarter, we were able to start our buyback program after we received authorization to do so. So capital management continues to be strong, and you can see also the dividends flowing into the holding company continue to be strong, as we have said before.

On the Property Casualty front, continued progress on loss ratio when you look at the trendline. Remember, that's not a linear line, and it's a line that will up-and-down a little bit each quarter. The main thing is to look at its pattern over time. And it looks very good and continues to look good. We continue to get rate change in the segments that makes sense to get it. Our premiums are actually growing in spite of what's reported because primarily, it's reported down because of the currency exchange between the dollar and the yen, where we have such a big business in Japan. And during the quarter, while we are supposed to have big CATs, sometimes have little CATs and we have severe losses. And Peter will talk about that. So it was a modest quarter of what I would call catastrophes and severe losses.

The Mortgage Guaranty business continues to show its strength after we've redesigned its risk selection model. And so today, almost 55% of our premiums are in that new model that is showing off good, steady earnings on the legacy book. Delinquencies are down slightly. However, keep in mind that almost 75% of those who are delinquent had been delinquent before and they sure [ph] it seems that people just can't keep up with the timeliness of their payments. But so far, they're still keeping up with the mortgage overall.

On Life and Retirement, a very strong quarter of sales. Jay will talk about that. Good net flows as well, very good pricing on the products that are being offered out there. And so we're feeling very confident on that part of the business as well. So overall, I think all of AIG is performing well, and that gives us the confidence to look forward to the things we have to do as a company. So let me turn it over to David, who will take you through some more details.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Thank you, Bob, and good morning, everyone. As Bob mentioned, our insurance operations delivered a solid operating earnings of about $2.2 billion. And we continue to execute on our capital management plans and our businesses continue to work towards growing their risk-adjusted returns. As we've said in the past, ILFC remains a noncore asset and is accounted for as held-for-sale given our plans to monetize it through a sale or an IPO. We have already written ILFC down to a fair market value. And this quarter, when ILFC files their results with the SEC, they will have completed their annual aircraft impairment review. This review resulted in a $1.1 billion impairment from older, out-of-production aircraft. But this impairment has no effect on AIG's carrying value of ILFC.

Further to Bob's comments on our work towards our long-term goals, we've made good progress on deploying capital. We've deployed $18 billion in capital through equity buybacks, a combination of equity buybacks, debt capital management and the reestablishment of our common stock dividend. And importantly, we remain focused on generating deployable capital with distributions from our insurance operating companies of about $4.6 billion year-to-date through the third quarter. We've made good progress on our expenses, but we still got a lot to do in terms of investing in our infrastructure and our growth opportunities. We've also made good progress on improving our ROE and are committed to our strategies. You can see the progress we've made in reducing the accident year loss ratio in Property Casualty, which has declined roughly 3 points annually over the last couple of years.

Turning to our financials on Slide 4. Net income for the quarter was $2.2 billion and included an after-tax provision of $260 million for legacy litigation matters as a result of current period developments. We also determined that recently identified tax planning strategies met the prudent and feasible criteria, and we released through income about $900 million of our deferred tax asset valuation allowance relating to our capital loss carryforwards. Our capital gains-taking program has allowed us to realize roughly 63% of our capital loss carryforwards. In addition, we also released about $300 million of valuation allowance from foreign DTAs. Our operating ROE for the quarter was 6.2% and was 7.6% for the first 9 months. Since our earnings are tax-affected and we are not paying U.S. taxes given our NOLs, our ROE, excluding the DTA, would be about 130 basis points higher. Book value per share, excluding AOCI, was $62.68, up 8.3% from year end.

Our operating results begin on Slide 5. And you can see the solid growth in our insurance operating income from a year ago. Strong fundamentals are driving our business. Property Casualty comparisons are driven by accident year loss ratio improvements and lower CATs and continued benign prior year reserve development. Mortgage Guaranty continues to benefit from improving housing market and risk selection. Life and Retirement earnings were about $1.14 billion, reflecting continued disciplined spread management and lower alternative investment returns, offset by net favorable DAC unlocking from the annual assumption review. Life and Retirement premiums and deposits were very strong, totaling $8.4 billion. Peter and Jay will discuss these results further in their remarks.

The direct investment book in Global Capital Markets earnings collectively were $139 million in the quarter, reflecting continued appreciation in the portfolios, albeit at a somewhat slower pace from the first 2 quarters of this year. As we have stated in the past, the Direct Investment book and Global Capital Markets results are impacted by market pricing due to their mark-to-market accounting treatment. And earnings can, thus, vary significantly from quarter-to-quarter.

Corporate expenses in the quarter reflect our ongoing infrastructure build-out. A year ago, we benefited from an expense credit relating to the monetization of the U.S. Treasury stake in AIG, so the comparison is not straightforward. Our reported operating effective tax rate for the quarter was 18% and reflected a favorable tax settlement and related discrete items for about $200 million. Excluding this benefit, the effective tax rate was more like 32%. And we expect our annual effective tax rate to be roughly 31%.

Turning to Slide 6. You can see the impact of capital management activity year-to-date. In the quarter, we issued $1 billion of 7-year notes at just shy of 3.4%. And also in the quarter, we repurchased or redeemed in the quarter, and thus far in the fourth quarter, redeemed $1.1 billion with an average coupon of about 5.7%. In October, we also issued $1 billion of 10-year notes. Including the Direct Investment book, when you take into account our year-to-date liability management and our full year maturities, we're on pace to reduce our leverage by over $6.5 billion and reduce our annualized interest expense by roughly $325 million. On the equity side, we distributed $147 million in dividends to our shareholders and deployed just over $190 million, repurchasing 4 million shares. We will continue to be opportunistic in our debt capital management going forward, and we will continue to deploy our existing unused share repurchase authorization in an orderly way.

As you can see on Slide 7, our insurance operations remain a source of parental liquidity as they sent $1.9 billion in dividends and distribution to the Parent, and as I mentioned earlier, $4.6 billion year-to-date. These dividends, combined with the impact of our capital management activities I mentioned earlier, resulted in Parent cash and unencumbered securities of $12.7 billion at the end of the quarter. Included in the Parent liquidity is $5.9 billion related to the Direct Investment book, which is allocated for future debt maturities and contingent liquidity stress needs. As we've indicated in the past, nearly 80% of the Direct Investment book's liabilities mature by the end of 2018.

So at this time, I'd like to turn the call over to Peter for comments on Property Casualty.

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

Thank you, David, and good morning, everyone. Before I begin my comments on the quarter, let me echo Bob's comments about Kevin Hogan's return to AIG. Kevin is the right leader to grow our market-leading global consumer business, including life. And I believe they will prosper under his very strong leadership.

AIG Property Casualty results in the third quarter reflect our consistent focus on underwriting improvements and targeted growth. The current quarter benefited from modest catastrophe losses, our ongoing shift in business mix, increasing pricing and enhanced risk selection, partially offset by elevated severe losses and alternative investment returns that were lower than our expectation. As we discuss the quarter's result today, I'll highlight our focus on balancing growth, risk and profitability.

Turning to Slide 8. Net premiums written grew 3% on a normalized basis. This growth is consistent with our expectations for 2013 as we continue to be disciplined in our underwriting and opportunistic in our pricing actions. The accident year loss ratio, excluding catastrophes, declined by 3 points from the year-ago quarter, reflecting continued progress, improving our business mix and risk selection. We've said in the past that there would be quarterly volatility in the accident year loss ratio. And this quarter, we experienced severe losses of $211 million, which are concentrated in 7 property losses largely outside of the United States. We continue to expect improvement in our underwriting results.

Pretax operating income of over $1 billion included lower catastrophe losses of $222 million versus $261 million a year ago. Catastrophe losses related to multiple perils around the world, including Colorado flooding, wildfires and European weather events but no major U.S. windstorms. Our reserves remain stable and net adverse development was $72 million in the quarter compared to $145 million a year ago, a benign level given our $63-plus billion of reserves overall.

Turning to Slide 9. Commercial Insurance continued to progress in reshaping its portfolio across products and geographies. Excluding casualty, top line growth was 9%. And as you know, we have been reunderwriting our casualty book. Thus, overall commercial top line growth was a net 2%. We grew in risk-adjusted profitability accretive lines or RAP-accretive lines and regions, including property, financial lines and specialty while continuing to reduce exposure to U.S. casualty and certain European liability segments. Rate increases globally for commercial lines were 3.4% and the North American market continues to lead rate improvement with a 5.5% rate increase in the quarter. U.S. casualty led with a 7.3% rate increase while U.S. financial lines increased 5.8% and U.S. property increased 3.9%. We've also used highly differentiated rate to improve our retention strategies. And as a result, retention is higher among our higher-quality risks. Our commercial accident year loss ratio, excluding catastrophes, was down 4 points from the prior year to 66.2% despite a $91 million increase in severe losses as we see a sustained benefit from our enhanced risk selection, pricing discipline, exposure management and claims management. The sequential trend was impacted by severe losses, which demonstrates the volatility within any 1 quarter.

Turning to Slide 10. Consumer net premiums written grew by 4% on a normalized basis. Consumer growth was driven by momentum through multiple distribution channels. Accident and health net premiums written reflected declines in the U.S., offset by growth in Asia, while personal lines grew 7% on strong growth in the U.S. Profitability in the quarter was negatively impacted by retail warranty losses in the U.S. We have taken actions to improve rates and amend terms and conditions, which should return margins to target levels promptly.

Slide 11 illustrates our investment portfolio, mix and quality. While the low interest rate environment and alternative investment returns affected net investment income in the quarter, we continue to be pleased with our overall returns and are satisfied with our strategic asset allocation. In the quarter, we made a $716 million dividend payment to the Parent and expect to contribute our planned dividends for the remainder of the year. As we look at our 9-month performance, our continued focus on balancing growth, risk and profitability has delivered almost $1 billion of high-quality additional operating profit from a year ago.

Turning to Slide 12. Our Mortgage Guaranty business reported operating income of $43 million, which represented another quarter of improving profitability and growth in new business. Mortgage Guaranty continued to benefit from its proprietary risk selection model and an improving housing market with 55% of earned premiums generated by high-quality business written after 2008. Delinquency fell to 6.4% at the end of the quarter for a 1/3 reduction compared to the third quarter of last year. UGC continues to be strongly capitalized and holds an investment portfolio that's highly liquid with 85% of the investments rated A or better. As a leading U.S. mortgage insurer, UGC currently insures 780,000 mortgages across the country.

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

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

Thanks, Liz, and thank you, Peter, and good morning to everyone. I'm going to begin on Slide 13, where you can see that AIG Life and Retirement delivered another strong quarter from both a top line and bottom line perspective.

Operating income was $1.1 billion in the third quarter, up 38% from a year ago. The year-over-year comparisons were impacted by several items in each period, including a net positive unlocking of assumptions in the current quarter versus a charge in the year-ago quarter, primarily related to our GIC portfolio and other liabilities. Even after adjusting for these items, we delivered bottom line growth in the quarter with positive comparisons across the majority of our product segments. Strong fundamental trends, including variable annuity fee income growth and continued enhancement of profitability through active spread management, were key contributors to our favorable earnings comparison.

The third quarter highlighted the strong cash generation capacity of our business. As David mentioned, AIG Life and Retirement distributed $1.2 billion to the Parent this quarter, bringing our year-to-date dividends and loan repayments to more than $3.1 billion. This reflects both our solid capital position and the strong profitability of our businesses across multiple product segments. And even after the payment of dividends, we grew shareholders' equity, x OCI, by $2.2 billion since year-end 2012, ending the quarter at $33.8 billion in shareholders' equity, x OCI.

We continue to experience strong sales momentum. And this quarter achieved our highest level of sales in Life and Retirement's history. Innovative product designs, favorable market conditions and increasing effectiveness of our distribution strategy all contributed to a 118% increase in Retail premiums and deposits from the year-ago period. Sales increased across all Retail investment products from both the prior quarter and the year-ago period. Surrender rates also declined sequentially across all product lines. Individual variable annuity and Retail Mutual Fund sales momentum continued, reaching $2.4 billion and $1.6 billion respectively for the quarter. We also saw meaningful acceleration in Fixed Annuities sales, which reached nearly $1.2 billion in the quarter. Growth in Institutional premiums and deposits was driven by a mid-sized pension buyout case and a large group retirement plan takeover in the quarter. Additionally, we closed on $5.3 billion of stable value wrap business in the quarter, bringing total stable value wrap assets under management to approximately $19 billion at the end of the quarter.

Net investment income declined 5% in the quarter, largely due to lower-than-expected alternative investment returns and the continuing impact of reinvesting at rates below our current portfolio yields. However, while reinvestment rates were lower than current portfolio yields, they have increased sequentially for the past 2 quarters. We continue to be opportunistic in our investing strategy and seeing attractive opportunities across various asset classes. Operating income benefited from the increase in fee income, as well as our ongoing strategy of active crediting rate management to enhance profitability in both our Retail and Institutional spread businesses. Additionally, a net positive adjustment of $118 million related to the review of gross profit assumptions and an associated positive unlocking is reflected in operating income for the quarter.

Assets under management increased 10% from a year ago as a result of growth in both the Retail and Institutional businesses, demonstrating the value of our diversified business model. Sales momentum and strong equity markets contributed to growth in Retirement Income Solutions, Retail Mutual Funds and group retirement assets. Net flows from these products and our Fixed Annuities business were $2.5 billion in the quarter for an increase of nearly $3 billion versus the year-ago quarter. All product lines contributed to this favorable trend with the majority of the improvement driven by the increase in Fixed Annuities sales and continued strength of variable annuity and Retail Mutual Fund activity.

In the institutional markets, as previously mentioned, the development of the stable value wrap business added over $19 billion in AUM over the past year, all with contractual fees and investment limitations on the wrapped assets well within our targeted pricing and terms. With the quarter's rise in interest rates, we did see the unrealized gain position in our invested asset portfolio modestly decline. This decline partially offset a portion of the increases in AUM we experienced from the improved net flows. Overall, we're pleased with the growth in AUM we are seeing across our portfolio of businesses.

Slide 14 highlights the diversity and scale of our businesses. Retail operating income increased 54% versus a year ago, primarily due to growth in fee income on separate accounts, as well as crediting rate actions, which together contributed approximately $100 million of increase in earnings. Retail earnings also benefited by 108 -- $198 million from net positive adjustments related to our review of gross profit assumptions, principally due to differences in our yield and mortality assumptions versus our models. Institutional operating income increased 7% and also benefited from higher fee income on separate accounts and crediting rate actions. These positive trends in our Institutional business were partially offset in the quarter by lower net investment income, as well as an $80 million negative unlocking adjustment related to our group retirement business as a result of lower investment yields previously assumed in our DAC model. The comparison to the year-ago period is also affected by $110 million charge related to our GIC portfolio that we took in the third quarter of last year.

Our sales trends continue to reflect strong consumer demand and increased distribution penetration for our investment products. In Fixed Annuities, crediting rates have risen in line with market interest rates, making this product more attractive when compared to competing bank and short-term fixed income products. Consequently, we are seeing volume growth while continuing to achieve increases in our targeted returns. Our $1.2 billion in Fixed Annuities sales is a high for the past 7 quarters and is consistent with the improvement in the market overall. Fixed Annuities sales moderated with the recent pullback in market interest rates in October but continue to be at levels higher than the first and second quarter of this year. We're pleased with the current pricing conditions and look forward to continued Fixed Annuities sales momentum assuming a modestly rising interest rate environment.

Our Retirement Income Solutions business continue to grow profitably, and we remain comfortable with our sales run rate. By offering a product to consumers that is competitively priced and meets their income and investment needs with terms and conditions conservatively designed to enable us to manage our risk effectively, we've been able to grow our book of individual variable annuity business in a controlled and profitable manner. At quarter end, our variable annuity account value, including both fixed and separate accounts, was $35 billion in our Retirement Income Solutions business and over $54 billion in our group retirement business. And as an update to last quarter, of our $25 billion of VAs with guaranteed minimum withdrawal benefits, 63% are in benefits with strong derisking features, such as VIX Index-ing of fees, volatility control fund requirements and required minimum allocations to the fixed account. So the combination of a relatively small legacy block and enhanced risk controls in our current features has allowed us to capitalize on opportunities when competitors have chosen or been forced to pull back from the market.

Finally, Slide 15 and 16 depict our investment portfolio composition, returns and yields. Overall, base yields declined slightly in the quarter as the result of the impact of investment purchases made yields lower than the weighted average yield of the existing portfolio. At the same time, we've actively managed down crediting rates over the course of the year, which is reflected in the lower cost of funds for both our Fixed Annuities and group retirement businesses. Overall, spread expanded for both Fixed Annuities and group retirement from the prior year. At the end of the third quarter, about 3/4 of our fixed annuity and universal life account values were at minimum guaranteed crediting rates. And we remain focused on managing spreads actively.

To sum it up, we're pleased with our solid earnings, strong sales, improving net flows and level of cash distributions to AIG through the first 9 months of the year. We remain focused on executing our growth strategies by leveraging our strong relationships with distribution partners to increase profitable sales of our broad product portfolio across all channels, while continuing to look for opportunities to grow our business where we can achieve the most attractive risk-adjusted returns.

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

Elizabeth A. Werner
Head of Investor Relations and Vice President
Thank you, Jay. Operator, could we open up the lines for our Q&A period, please?

Question and Answer

Operator

[Operator Instructions] We will hear first from Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

So I guess, one question, Bob, maybe on ILFC. I guess, if that does -- if it's not resolved immediately, I mean, does that imply it could come back on the balance sheet? And could that complicate the SIFI review process at all?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I don't think it would complicate any SIFI process whatsoever. I think it's a noncore asset. We would continue to divest and deconsolidate it. And we'll do that in as rapid a time as it makes sense financially for the company to do it. We know what the value of that company is. We know what's been accomplished. And when you refinance almost $20 billion of debt and do it in a way that gives us a very tight match between cash flows and debt maturities and so on, I think it's a property that we can divest of. But I'll have David talk about the actual accounting.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

There are 2 things. One, on the balance sheet held for sale, that's one "accounting" judgment, and then there's another judgment we make with respect to discontinued operations. And those are 2 different judgments connected, but they're 2 different judgments. And the held-for-sale treatment is pursuant to our plan. We have a plan. We are pursuing the plan. It includes pursuit of the jumbo transaction. But there other interested parties, as we've said, as well as an IPO alternative. So there's a solid basis for the held-for-sale. Then the question is on discontinued operations, depending upon the ultimate disposition path, we need to make a determination whether or not we will have significant continuing involvement. And that will be a facts-and-circumstances judgment that we'll make. And we'll continue to evaluate facts and circumstances. So the held-for-sale, it's not going to come back on balance sheet. And so now it's just a matter of how we go about divesting it.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And I guess, maybe, David, on partnership returns, I guess, you noted in your disclosure that returns were impacted negatively by equity markets. But I'm just trying to remember the lag, I think, of either 3 months or 1 month, depending on the investments. Equity margins have been pretty strong. I was trying to understand, even not relative to last year, but just relative to sort of a run rate the returns will grow [ph]. I'm just trying to get a better understanding for how we should think about that.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Sure. And I'll comment. Bill, if you want to, yes, add anything. The partnerships are a quarter lag and the hedge funds are a month lag. Yes, private equity partnerships are a quarter lag. Bill, anything to add?

William N. Dooley
Executive Vice President of Investments

Yes. Mike, as far as the year is concerned, first of all, these returns aren't linear each quarter. So they're a little lumpy, where our mark is somewhere between or our goals are somewhere between 8% to 10%. And already this year, we're close to our annual goal on the return on these assets. So even though this quarter was lighter than the previous quarters this year, we're still very confident in it. And as David said, the hedge fund part of the portfolio is in the books already. We just don't know what it is because we need information flows to come in and hedge funds have 1 month to go. And there is a correlation between that and the markets. And you guys can judge from where the markets are today and how the quarter is going to wind up. But I think that asset class is certainly performing the way we expect it to.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay. I mean, just real quick on that. I mean, if we did that math backwards, so I guess, we wouldn't quite get there. And I wonder is that 8% to 10% return goal against a backdrop of a market that has risen as much as equity markets has risen this year. And this could be just a wrong assumption, but that would kind of gradate with the underlying returns in the equity markets and not be sort of a kind of fixed return threshold?

William N. Dooley
Executive Vice President of Investments

No, it's not a fixed return threshold. As I said before, these returns aren't linear. And the type of funds that we invest in, depending on the volatility of the fund, the risk associated with the funds, we try to maintain the 8% to 10%. And as I said, we're in good shape through the first 3 quarters to attain those goals.

Operator

And now we'll take the next question from Josh Stirling with Sanford Bernstein.

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

A question for Peter, if I may. You have made a lot of progress in commercial lines. And in particular, I'm wondering if we could talk a bit more about consumer. When I think about these businesses, most of them are structurally more attractive than your consumer lines, lower elasticity, lower risk and not really as broken. But you haven't, thus far, been getting a kind of margin momentum, and recognize this is partially you're investing in growth and maybe some other, just getting the team in order. I'm wondering if you can walk us through a bit more granularity what you guys intend to do to actually drive the consumer combined ratio to a low 90s number and sort of what a realistic trajectory that would be deployed through?

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

I think that the first thing to remind everybody is how much of our consumer business is in Japan. And so what's going on there is a major merger integration effort between Fuji Fire and Marine, AIU and an integration of many capabilities, which will improve the expense picture on the, by far, the largest consumer operation we have. So that is certainly progressing well, and we expect that to improve the margins in what is a large and stable book of business. But it's not growing that fast obviously with the demographics in Japan as they are. The one exception there is the excitement we have about Fuji Life. And so we see good growth there as we rebuild the life business, taking advantage of the aging population in Japan. The other dimension is the investments that we're making in building a firm foundation for growth, scalable growth in emerging countries. And I'd say that there are 3 large emerging countries which we've been investing quite heavily in over the last year, where we have taken perhaps a little longer than expected to build the platform we wanted and get the sales kicked off at the rate that we like. But we have still a high degree of confidence that those platforms will perform fairly, fairly promptly. So slightly delayed startup in 3 large emerging markets, which we're investing in. And then the U.S. A&H story is somewhat negative for a variety of reasons that are kind of one-offs. But we've got other quite good growth momentum on the consumer side, especially on the extended warranty side despite the short-term profitability issue that we talk about in this quarter on one particular extended warranty program.

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

That's helpful. Bob, if I could switch to sort of a bigger topic. I get that -- we all get that you don't want to provide guidance and the aspirational goals were stretch goals back in 2010. But you since made a lot of progress against them. And so when you say, I think I'm getting this right, that we're not sure we'll get them done by 2015, investors just wonder what to expect. And recognizing you're not going to give guidance, there, I think, were fundamentally 3 big pieces to the aspirational goals: driving ROE 10%, returning capital $25 billion to $30 billion and investing to get some growth and rebuild the franchise. I'm wondering if you could at least give us a directional sort of color on which of you think -- which of these big pieces do you think may be at risk?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I don't think -- first of all, you're assuming it's at risk. What we're saying is that once we get closer to the time, we need to give you maybe a range around it. We've discussed a whole lot of things one would have to do once we get closer. Because look, if I could tell you exactly what I could be at exactly a point in time, I think I would have problem with some of the people in Washington in the enforcement group because you can't run this business with that degree of accuracy, and you all know that. What's important is we look at how we're running it and what our focus is on different things within this company. And we have said we're focusing on expense. And we've been investing a lot of money to get our expenses down. So we had to spend to eventually see the savings. We've talked about our investment portfolios and the things we're doing there. We've talked about making sure we understand our cost of capital for the businesses and the risks we're taking. And we want to earn more than our cost of capital, especially in the Property Casualty business, where there's been a big focus so that we are capital-light on the things that make the most sense for us. So we're continuing to do all of that, and all comes together, including capital management. So it's not a question of anything other than, as you go through all of these things, when we get closer to 2015, you're going to ask us to be a little bit more specific, and it becomes more of -- instead of an aspiration, it becomes we will achieve something around this in this period of time. And that would be guidance, and that's what we're concerned about. So we're focusing on all of it. And we're proud of the progress we've made. And we're putting a lot of energy to achieve all of it by 2015. But what I'm saying to you today well in advance of that time is we may not get there by 2015, it might be a little later. And that's about all the comment we could make on the whole subject. But I think you need to look at our progress every quarter, look at the trends every quarter. And I think you'll see continually improving organization here.

Operator

And now we will hear from Adam Klauber, William Blair.

Adam Klauber
William Blair & Company L.L.C., Research Division

The ramp-up in some of the Life and Retirement products is very good to see. I guess, 2 questions. Do you think it's the earlier part of the ramp-up? In other words, can you continue to accelerate? That's number one. And number two, how should we think of the returns of that business today, particularly the Fixed Annuities business today, compared to what they've been more recently and historically?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Jay?

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

Sure, I'll take that one. First of all, in terms of the ramp-up, I think that the potential demand for the products we're selling based on demographics, a greater concern about longevity risk, outliving their savings and such, is definitely there, as well as the continued movement of money from defined benefit pension plans into defined contribution plans and ultimately to IRA accounts, where the money moves from, in effect, institutional management to retail management and more personal control. I think that a primary driver though of kind of the quarter-to-quarter growth is going to be -- have a lot to do with market conditions, the equity markets, certainly rates, the shape of the yield curve and such. But I think the underlying demographics in the basic demand growth will continue to be there. But market conditions will have an overlay that's going to play a big role in quarter-to-quarter results. You saw, for example, this quarter a very significant increase in fixed annuity sales based on rate movements. And we generally follow the 10-year treasury assuming credit spreads are the same quarter-to-quarter. And you saw the kind of movement, not only for our company, where we are able to take advantage of that, but really for the industry, as I mentioned in my comments. At the same time, the pricing continues very strong. We continue to target pricing for fixed annuities in the roughly 11% to 12.5% return on equity or internal IRR basis. And we continue to get that pricing we believe at the time we're writing that business. So pricing is actually very good in this environment. Market conditions will depend a lot on rates and spreads. And I think we'll be ready to go with our low-cost operating platform and our very strong distribution organization to take advantage of that or any other product segment that grows going forward.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I'd just like to add to what Jay just said the fact that people wonder about the businesses, keeping them together and the diversity of risk and the diversity of dividends to the holding company and so on. But a startling number that just keeps hitting me is that over the next 35 years, there will be 4x the number of people over 65 than there are today. So forget about percentages and numbers and all the other stuff, that is 4x the number of people in that age category. And that is the area where we do a lot of business, where we deal with protection and life and other products. So we see the opportunity not only in the U.S. market, but you have those statistics maybe even more exaggerated in China. So this is a great growth business for us over time. So it's not only quarter-to-quarter in the markets, but it's also about client need.

Operator

Next, we'll hear from Greg Locraft with Morgan Stanley.

Gregory Locraft
Morgan Stanley, Research Division

Just wanted to get a little more detail on -- the tax rate we were expecting was in the low 30s, you put up an 18%. You mentioned the credits in the commentary. Can you go into kind of the timing around that, what they were and whether there's any more like that coming forward?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

It's David. Again, we'll address discrete items in any particular quarter as they occur. And we'll give you plenty of disclosure around that. And so the 31% rate that we expect going forward is really a reflection of the sort of the ongoing operations. As you know, over the last couple of years, we've done some portfolio rebalancing in Property Casualty to reduce our holdings of tax-exempt securities so that certainly affected the effective tax rate. So again, I'm not going to give you any specific guidance as to what to expect. Again, the 31% is really sort of a normalized rate. And then we'll break out the discrete items that we do, and then we'll let you know when those occur.

Gregory Locraft
Morgan Stanley, Research Division

Okay. I guess, what I'm wrestling with, and I know you mentioned this earlier, but it's just the difference between, I don't know, the definition of aspirational and guidance. I mean, to me, they're the same thing. And in a quarter where the pretax miss was pretty sizable, why choose now to suspend guidance effectively going forward? And I appreciate you guys are aiming for 10% plus. But even then I thought that the plus would have covered you from -- you don't have to give decimal point accuracy, so to speak. I just don't know why right now you would be suspending guidance.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

It's very simple. We're getting too close. You want to wait until next quarter or the quarter after? Sooner or later, we're going to face this issue. And so the feeling is that guidance is something that I believe from what we've looked at, we have a likely chance to achieve. Aspirational says as we look at this company and all the things we need to do over a 5-year period, we believe that we could get to this kind of target. And so the word aspirational and why we used it was to say to you that we don't have a plan specifically that says you can get there. We haven't gone through the details. But we knew that directionally, if we do a whole lot of things and it began to take hold, we could get into that ballpark. And so we're going to get a journey. We're going to get to Southern New York. Now if you're going to ask me, "Well, are you going to make it to Westchester? Are you going to make it to Putnam? Or are you going to make to Manhattan?" That's guidance.

Gregory Locraft
Morgan Stanley, Research Division

Okay. Lastly, just for Peter maybe, on the pricing outlook in P&C. I don't know if you've given a lot of color on where you think it could be. But it's decelerating a little at the margin. It's great to see the gains. But how do you think this thing plays out going forward from a pricing perspective on the commercial side?

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

I'll actually pass that one to John Doyle. So why don't you pick that up, John?

John Doyle

Thanks, Peter. Rates were up for us in the U.S., where rate is needed the most, about 5.5% in the quarter, a little down from the second quarter. Casualty rates in the U.S. remain fairly strong. The property market seems to have gotten a bit more competitive. We've been observing that over the course of the last several months. But I expect the same factors driving pricing improvement in casualty in the U.S. to continue over the near future.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I'd like to also -- and John's answer is very correct. But underneath that answer is something that many of you would not know. And that is the amount of analytics going into understanding what is our account quality index, thinking about the quality of clients, the quality of the risk and so down the line to make sure we've segmented that in a much more refined way. We're now looking at brokers and what the broker quality index is, so we know the kind of business that's being brought to us by brokers. Some of them looking for taking a shot in the dark and hoping somebody at AIG will write it versus somebody who really prides their business with AIG and tends to bring us very good risk and very well field underwritten. And so when we talk about price increases, we actually look at it by these segments, and we're going to get more refined by these segments. So we have very good retention in our best clients and very little rate increase, but we're getting pretty good retention in some of our lower-quality clients, where you need the rate because of the performance of those accounts. And so it isn't just following the market anymore, we're becoming much more scientific in where in our client base or brokerage-brought business do we want to begin to add rate? And that would be independent of what's actually happened in the market. So it's not just the old everybody's up and down by the tide. So I'm very impressed and very optimistic about what John has been doing, in particular, in the whole commercial business with Peter. So that's a different level of detail behind that answer.

John Doyle

Yes. Bob, I would add beyond the tools that we're building to help making better judgments at the underwriters' desk, we've made big investments in claims side as well, in people, in process and in technology that are enabling better results for us to reduce the cost of risk once the claim hits. And so that's an important part of the improvement as well.

Operator

Now we'll take a question from Joshua Shanker, Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

My first question is for Jay. In terms of the amortization of the DAC on the life business, interest rates were kind of stable during the quarter, but you've got a benefit there. Can you talk a little bit about thinking about what went into this quarter's change in the DAC and what we might see happen in future quarters if rates go up and when that actually hits the P&L?

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

I'm going to -- actually Mary Jane Fortin, our CFO, is with me. I'm going to let her take that question.

Mary Jane Bartolotta Fortin
Former Chief Financial Officer

Yes. In terms of the DAC, you're right in terms of the fixed annuity business. What we saw there were really 2 things, the yields on the portfolio supporting the book were better than what we had modeled, as well as, Jay has talked to you about the crediting rate actions we've been taking and really managing the overall spreads, that benefited us in terms of the actual spreads coming through versus what we had assumed in our model. Our model, if you go back a year ago, still was anticipating continued pressure around yields and spreads. And we've been able to really manage through that by both the investing side and actively managing the crediting rates.

Joshua David Shanker
Deutsche Bank AG, Research Division

This might sound somewhat naïve, but I would've probably thought that would happen more likely in 2Q, when we didn't see it, than in 3Q.

Mary Jane Bartolotta Fortin
Former Chief Financial Officer

Well, we do our annual review of the critical assumptions on an annual basis. And so we are tracking our actual experience quarterly. But we do, do a detailed review. And we also want to make sure we see the patterns emerge over time. And so this was really, since last year, the first time that we did a detailed review of where the yields and spreads were coming in, and therefore, adjusted in the quarter across the whole Life and Retirement portfolio.

Joshua David Shanker
Deutsche Bank AG, Research Division

Okay. Very clear. And on share repurchases, what told you, you had about capacity for $200 million of repurchasing during the quarter? And I'm wondering if you were blacked out for any periods in the quarter or otherwise.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Brian, why don't you go ahead and give Josh some color on that?

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

Sure. We received authorization midway through the quarter in August, so we didn't have a full quarter. And we also have a blackout date that started on September 15, so really only in the market for, I guess, 27 days. We didn't have $200 million of capacity. That's how much we did because we wanted to be just disciplined in how we were deploying the authorization.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, we have -- our capacity, Josh, was $1 billion. We have the authorization for $1 billion. We used $190 million. And so again as I said in my remarks, we'll remain committed and disciplined around deploying that capital.

Joshua David Shanker
Deutsche Bank AG, Research Division

And is it reasonable to say you get about 25 days a quarter that you can be in the market?

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

No -- yes. But again, it depends on when we get the authorization, where in the quarter it is...

Joshua David Shanker
Deutsche Bank AG, Research Division

That's true. Right, this quarter, you already have the authorization, so you have more days.

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

Right.

Operator

And now we will hear from Jay Cohen with Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Two questions on the Property Casualty side. The first is you had some adverse development in the primary casualty business more so than we've seen in the past. And I'm wondering what's going on there, what drove that. And then secondly, just explain what happened in the Retail warranty business, what drove those losses. It wasn't quite clear from the press release.

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

Why don't you take the first question, John, and I'll take the second?

John Doyle

Jay, the adverse TYD [ph] we experienced in primary was related primarily to construction defects. And really, what -- we saw some increased frequency. We accelerated a review that have been scheduled for a later period, and really impact of prior major CAT events, as well as the expansion into some new states that historically hadn't been troubling in this regard. We've had historically tracked a couple of different states, where CD had been a challenge for us. We saw again some increased frequency and some new states accelerated a review. And I would also say beyond the impact of major CATs in the United States, also the impact of the credit crisis. Now we're observing a tale that's longer than what we had expected and the issue moving into some other states. So again, we accelerated a review and dealt with it in the quarter.

Jay Adam Cohen

BofA Merrill Lynch, Research Division

Great. And the warranty business?

James E. Mostofi
President of U.S. Warranty Division

Yes. On the warranty business, this is working with 1 or 2 large retailers, and in particular, 1. So this is a program where the profits and the risks are shared with the retailer. And there as a mechanism to true-up through rate change historical profitability. So while in any given quarter, you can have fluctuations, which we've had, we have confidence that we can recoup those adverse results within a very prompt period. So it really is a partnership with the retailer, and there's not as much risk transfer as the numbers would suggest.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

What kind of underlying products are we talking about? Is it white goods, computers?

James E. Mostofi
President of U.S. Warranty Division

All of the above, but in particular, mobile phones in this quarter.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Operator, I think we're at the top of the hour. And so I know we have a lot of questions in the queue. I'd like everybody to reach out, and we certainly do want to respond to all your questions and make sure we get back to everybody. So thank you for joining us this morning, and we'll look forward to talking to you in the future.

Operator
Ladies and gentlemen, this will conclude your conference for today. Thank you for your participation.