S&P Capital IQ

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American International Group, Inc. NYSE:AIG

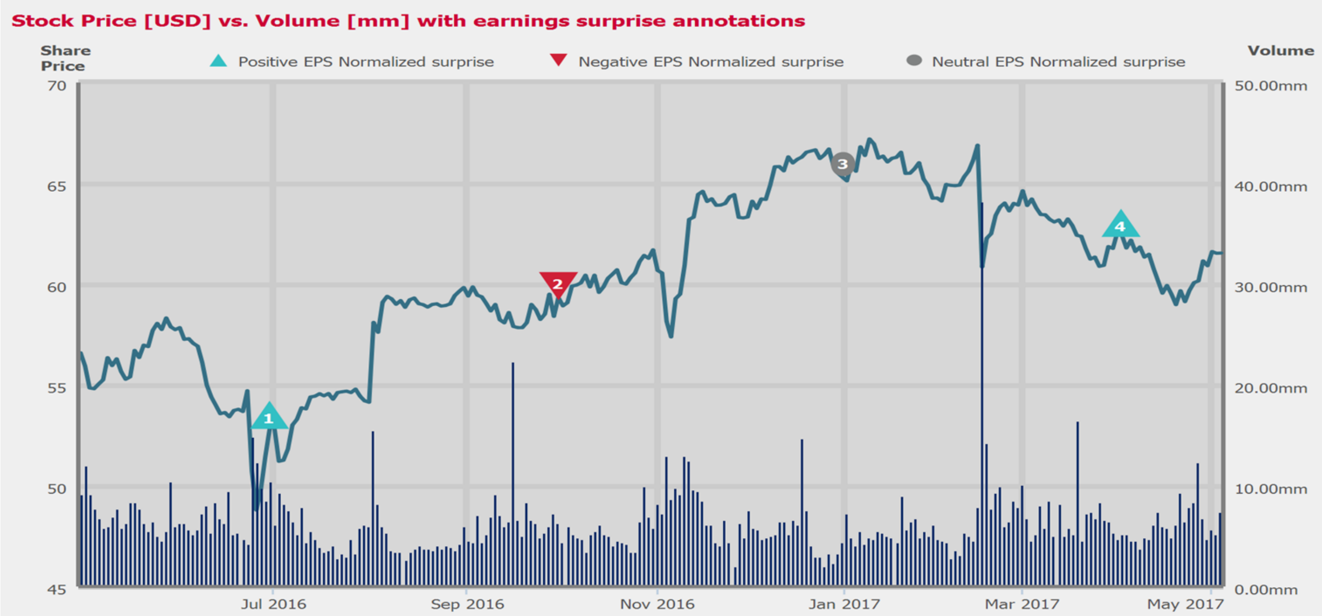
FQ2 2017 Earnings Call Transcripts

Thursday, August 03, 2017 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2017-			-FQ3 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.20	1.53	▲27.50	1.21	5.08	5.65
Revenue (mm)	12609.00	12502.00	▼(0.85 %)	12398.00	51264.00	51099.00

Currency: USD
Consensus as of Aug-03-2017 12:36 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2016	0.94	0.98	▲1 4.26 %
FQ3 2016	1.21	1.00	▼2 (17.36 %)
FQ4 2016	(0.57)	(2.72)	NM
FQ1 2017	1.07	1.36	▲3 27.10 %

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Presentation

Operator

Good day, and welcome to AIG's Second Quarter 2017 Financial Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Ms. Liz Werner, Head of Investor Relations. Please go ahead, ma'am.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, Anthony. 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 and second quarter Form 10-Q and our 2016 Form 10-K under Management's Discussion and Analysis of Financial Conditions and Results of Operations and under Risk Factors. AIG is not under any obligation and 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 in our financial supplement, both of which are available on our website.

This morning, you'll have the opportunity to hear from various members of our senior management team, including Brian Duperreault, Sid Sankaran, Rob Schimek and Kevin Hogan. And with us in the room today are Peter Zaffino, Seraina Macia and Doug Dachille. The format will follow the past calls. [Operator Instructions]

With that, I'd like to turn it over to our CEO, Brian Duperreault.

Brian Duperreault
CEO, President & Director

Well, thank you. Good morning. It's great to be here today and talking to you about AIG. It's been a busy few months, and I want to give you a sense of where we are as a company and why I am excited about AIG's future. The second quarter is a great indication of the breadth of our businesses and the opportunities for growth they provide. Overall, our second quarter results were solid. Consumer delivered another strong quarter of growth. Commercial continues to execute on its mix shift and manage through a very challenging property casualty market.

Before I get into the numbers, I want to note that going forward, we will no longer be providing guidance with targets. But today, I will speak to the actions that will improve the bottom line and drive shareholder value. Financial targets are important in how we manage the company, but they have to be put in balance.

I would like to share my thoughts on Commercial, Consumer, talent, growth and capital. Over the past few months, I have spent my time in the field and with our business leaders. As you might expect, I started with Commercial. Our goal in Commercial is to improve the bottom line. And the best way to do that near term is to shift our mix of business while continuing the emphasis on risk selection. The Commercial team has made good progress reducing our U.S. Casualty exposure, shrinking the gross book by 1/3 from 2015. Those risks were easily absorbed by the market. And we've seen a market with capacity to underwrite at prices, terms and conditions that we find unacceptable.

Improvements in our underwriting are emerging and will continue to positively impact our results, but we are not done. We still have portfolios that don't meet profit targets, including Property. Given market conditions, fixing them most likely will require further reductions in premiums written. Disciplined

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underwriting should also reduce the concerns surrounding our reserves. This quarter, roughly $16 billion of reserves were reviewed, including some of our most challenged lines, where we've seen adverse development in the fourth quarter of previous years. Most recent accident years, which are still green, are developing as expected. I believe our reserve review and loss pick process is sound.

Moving on to Consumer. These businesses represent roughly half of the company's core equity and are a valuable source of earnings stability. We enjoy leading market positions across many products and distribution channels, which allow us to maintain profitability in evolving markets. Personal Insurance, in particular, has significantly contributed to the quarter's profit growth and provides a great opportunity for future growth. Expense discipline is a hallmark of a great company. Good work has been done to reduce our cost structure. A balance needs to be set so that we invest in both people and technology that produce long-term productivity gains while addressing costs that produce no value add.

I heard many concerns about talent before I arrived. There is no question AIG lost talent, but it was also blessed with a strong bench. The job now is to rebuild that bench. We are regaining our position as the best company to work for in our industry. I'm going to take full advantage of that as a net acquirer of talent. You've seen our recent announcements, and we're excited that Peter Zaffino and Seraina Macia have joined the team. Having spent 5 years working with Peter, I know that his focus and leadership will drive operating excellence and expand AIG's franchise. Seraina is no stranger to AIG. And she is coming back as the CEO of our new technology-driven subsidiary. Under her leadership, we will build upon the Hamilton USA platform, where she was previously CEO.

I also intend to maximize the value of AIG's international footprint in over 80 countries. The global presence simply can't be duplicated. And we will empower our people to develop and expand upon it. As I mentioned back in May, I'm here to grow this company profitably. In addition to targeted organic growth opportunities, we will consider acquisitions that are strategically complementary. I have a track record of building value through acquisitions. And you could expect that I bring that experience and philosophy to AIG. We will consider opportunities that are additive with respect to diversification and the balance they bring to our existing portfolio and capabilities, along with future profitable growth. Areas where we see opportunities may be found internationally, in personal lines, Life Insurance and in the U.S. small to middle market, to name a few.

Our capital management strategy will support our goal of profitable growth. And while we will return capital to shareholders, we intend to prioritize our investments in organic and inorganic opportunities. We still have a buyback authorization in place and will consider capital return but are no longer targeting an annual amount for share repurchase. We have already repurchased half the company's market cap over the past 3 years.

Going forward, our priority is to allocate capital to support profitable growth, both organic and inorganic. This company generates a significant amount of free cash flow. And as we generate excess cash, we can consider capital return, including our dividend payout, given our growth outlook. To reiterate my comments at the Consumer Investor Day, growth in profitability and book value are the measures of success in our business.

Finally, on the topic of being a bank SIFI -- nonbank SIFI, I should say, I've looked at it, and I think if you consider where we are today, we would not meet the hurdles for that designation. This company has dramatically changed its risk profile and controls since the financial crises. The data used for designating firms supports that statement when you compare us to peers. And we will continue to work with our numerous regulators to demonstrate the substantial and successful derisking that AIG has achieved.

I often remind everyone that there are a few companies in the insurance industry with the scale, global footprint and brand of AIG. Not only am I excited by what I've seen, I know what this company is capable of doing based on my long history at the company and my prior roles at one of the largest broker partners and the largest competitors. My goal is to make AIG better than it's ever been.

In closing, I look forward to speaking with you again on our progress. And with that, I'll turn it over to Sid.

Siddhartha Sankaran

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Executive VP & CFO

Thank you, Brian, and good morning, everyone. This morning, I'll comment on our second quarter financial results and provide an update on our capital and liquidity.

Turning to Slide 4. We reported after-tax operating earnings of $1.53 per share, driven by solid operating performance, led by our Consumer business and in particular, Personal Insurance. Our results benefited from strong alternative investment returns driven by favorable equity markets and lower-than-expected cat losses. Even after removing excess alternative investment returns prior year development and lower-than-expected cats, normalized EPS was $1.33. Book value per share, ex AOCI, grew 2% during the quarter to $76.12 and 4% year-to-date. Book value per share growth in the long term remains an important objective for us in assessing value creation for our shareholders.

AIG's adjusted ROE was 10.5% and is shown on Page 5. And our core normalized ROE was 9.9% for the quarter. Capital management, operating efficiencies and Personal Insurance profitability positively contributed to the core ROE and were offset by increased Commercial loss picks from the second half of 2016. The year-to-date core normalized ROE was 9.2%. And we believe we're on track to demonstrate profitability in our core insurance operations for the full year.

Consumer delivered another strong quarter and saw 33% increase in pretax operating income relative to prior year. Consumer's normalized ROE was roughly 13% for the quarter and 12% year-to-date. Nearly 90% of Consumer Insurance's attributed equity generated a double-digit return this quarter. Commercial continues to execute on its strategy of mix shift and risk selection in a challenging market environment, which is evident in our reduction of net written premiums. Year-over-year comparisons are impacted by the second half 2016 increases in loss picks for U.S. Casualty and Programs as well as an increase in Property and Special Risks losses. Rob will speak to these items further in his remarks.

During the quarter, we accelerated the number of detailed reserving reviews we performed at Liability and Financial Lines compared to a year ago. We completed reviews of reserves totaling roughly $16 billion, including primary and excess general liability, medical malpractice and environmental. Historically, these have been among our most challenging lines. And it contributed roughly half of prior year development in the past 2 years. Also note that typically, these lines have been reviewed in the fourth quarter in previous years.

Based on our reviews, we recorded $21 million of net adverse prior year development in Liability and Financial Lines' operating earnings, net of reinsurance. This figure primary includes AIG's 20% share of development on covered reserves that are part of the ADC, offset by the $62 million in quarterly amortization of our ADC gain at inception. The adverse development on the 80% of reserves ceded to Berkshire Hathaway was $273 million and is reported below the operating line. The development associated with the ADC and the deferred gain treatment are provided on Page 47 of our financial supplement.

Prior year development for Liability and Financial Lines was due to adverse claim experience in U.S. primary and excess GL that related primarily to construction defects and multiyear construction projects that cover all contractors on site, also known as wrap business, along with other large individual claims. This was largely covered by the ADC. Based on the results of our detailed reserving reviews, we remain comfortable with our 2016 and 2017 loss picks in these lines. In addition, we also saw higher-than-expected losses in Property and Special Risks due to 2 large aviation losses and recorded $41 million of prior year development in PSR. Historically, we have had modestly favorable reserve development in these classes, which results in an unfavorable year-on-year comparison for Property and Special Risks.

Our balance sheet and free cash flow remain strong. Current liquidity at quarter-end was $7.8 billion. During the quarter, we received $1.7 billion of distributions from our insurance companies, including tax-sharing payments. Parent also received a total of $1.2 billion in proceeds related to legacy asset monetizations and the sale of Arch shares. Total proceeds from the sale of Arch shares was $652 million, of which roughly $400 million were received by the holding company. Our remaining 4% stake in Arch is held in preferred shares in our P&C subsidiaries that are subject to lockup until January 15, 2018.

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We continue to have the commitment and discipline in executing our legacy strategy. Legacy capital release in the quarter was $800 million for a total of $7.9 billion since the beginning of 2016. Cumulative capital release and cash flow from legacy have exceeded our expectations. We continue to project strong free cash flow to the holding company from insurance subsidiaries and the Legacy portfolio.

We returned $2.7 billion of capital to shareholders in the quarter. While we have $2.5 billion remaining under our share repurchase authorization, as Brian stated, we'll be more opportunistic in our buyback activity and are no longer targeting an annual level of repurchase. We have already returned roughly $20 billion in capital over the past 18 months, inclusive of our Q3 dividend. Going forward, our priority is to allocate capital to support profitable growth. Our balance sheet strength is an asset we will use to maximize return and value to shareholders.

To sum up, we are pleased with a second consecutive solid quarter. Our strong balance sheet and free cash flow profile distinguish us from others in our industry and leave us extremely well positioned for the future.

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

Robert S. Schimek
Executive VP & CEO of Commercial

Thank you, Sid, and good morning, everyone. During the second quarter, we continued to execute on our strategy to improve Commercial's profitability by achieving a healthier balance in our portfolio. We remain focused on disciplined risk selection, advancement of our pricing tools and improving our mix of business as we work to create long-term sustainable value for all of AIG's stakeholders.

On Slide 8, Commercial's second quarter normalized ROE of 7.6%, which includes the full capital benefit from the Adverse Development Cover, represents an improvement from the first quarter and is in line with prior year quarter after adjusting for the increase in loss picks recorded in the second half of 2016. The adjusted accident year loss ratio of 66.1% reflects elevated noncat Property losses and higher loss picks in Liability and Financial Lines, which offset improvements in risk selection, mix of business and strong performance in Special Risks.

We've continued taking aggressive underwriting actions across the portfolio's poor performing lines, particularly with the U.S. Casualty and Global Property. The chart at the bottom of the slide illustrates our focus on risk selection and improvements achieved in our mix of business over the course of the last year. However, the pace of our progress is partially dependent on market conditions. And as a result, we do anticipate quarterly volatility as we execute our strategy.

Turning to Slide 9. Liability and Financial Lines reported a solid second quarter normalized ROE of 11.3%, which reflects the full capital benefit of the ADC and strong performance in Financial Lines. The adjusted accident year loss ratio was essentially flat to the prior year quarter after adjusting the second quarter of 2016 for the increase in loss picks recorded in the second half of the year. During the quarter, benefits from risk selections and business mix improvements were offset by more conservative loss picks and market conditions.

In Financial Lines, we achieved meaningful growth in segments where we're earning our target rate of return and hold market leadership positions. That includes primary public and private D&O, where our claims capabilities have helped us to achieve above-market rate increases as well as Side-A D&O, M&A and cyber, where AIG's technical expertise is a clear competitive advantage. We continue to see opportunities in Financial Lines, and we're committed to innovating and growing with our clients.

Moving on to Casualty. We made progress on improving risk selection, enhancing the sophistication of our underwriting tools and achieving year-over-year above-average market rate increases of 3% during the past 7 quarters. As Sid mentioned, this quarter, we updated our reserve analysis on many of the most challenging classes within U.S. Casualty. Premium rate increases are lagging loss cost trends. And we have been prudent in setting our loss picks. Casualty is the long-tail line most vulnerable to uncertainty within our portfolio. And we recognize that we have more work to do.

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Turning to Slide 10. The second quarter normalized ROE for Property and Special Risks was 1.2%, reflecting strong profitability in Special Risks that was mostly offset by an underwriting loss in Property. We've shared our Property remediation plans with you in the past, and we acknowledge that the business is not performing at an acceptable rate of return. The quarterly increase in Property and Special Risks adjusted accident year loss ratio is attributable to Property's noncat losses. With respect to Special Risks, the second quarter marked our best adjusted accident year loss ratio quarter for specialty lines in the last 5 years. The proportion of our business coming from Special Risks has grown 5% over the prior year quarter, highlighting a deliberate shift to areas where we see profitable opportunities.

I'll make 3 key observations with respect to our Property business. First, cat losses performed better than our average annual loss expectation and better than the prior year for the first 6 months of 2017. Second, while severe losses were elevated compared to the past few quarters, they're in line with our expectations for the first half of the year. Third, we experienced higher property attritional losses in Northern Europe as a result of elevated claims activity relating to the 2016 underwriting year. In 2017, we believe improved risk selection, which has led to Property's premium decline, and significant enhancements to our tools will result in a stronger portfolio. Looking toward 2018, you can expect further remediation actions, particularly in Europe as we approach the important January 1 renewal season.

Shifting to some recent successes, I'd like to take a moment to recognize the significant progress we've made in advancing our modeling capabilities. In Europe, we recently gained PRA approval of our Solvency II internal model, an affirmation that external parties are gaining confidence in our tools. Our development of data, analytics, tools and modeling has been a multiyear process. But our efforts are increasing in maturity and helping to improve our business decisions.

Turning to our product and service capabilities. We're focused on bringing innovative solutions to our clients and brokers. We recently announced that we've successfully piloted the first multinational, smart contract-based insurance policy using blockchain in partnership with IBM and our client, Standard Chartered Bank. This just one example of a broader body of work dedicated to learning and working alongside our business partners as part of the commitment to client service and innovation that spans across the Commercial organization.

In closing, the second quarter marked another step on our journey to improve Commercial's underwriting profitability. Our strategy will remain focused on risk selection, underwriting discipline and improving the mix of business within the portfolio. We're extremely pleased to welcome and work alongside Peter Zaffino, who brings with him an accomplished track record and a fresh perspective from the broker community. I have confidence in our strategy, our teams and its ability to execute as we continue through the year.

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

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

Thank you, Rob, and good morning, everyone. As you can see on Slide 12, Consumer produced strong results for the quarter. We earned nearly $1.3 billion in pretax operating income and expanded normalized ROE to 13.3%.

There were a number of positive developments in the quarter which benefited our returns, including an unusually low level of loss activity in the Personal Insurance business and strong tailwinds from equity markets supporting fee income in our Individual and Group Retirement businesses. The strength of the equity markets helped partially mitigate the challenges and impact of the low rate environment on our results. Lastly, we had a one-time benefit from legal developments in Group Retirement and a positive adjustment to DAC in our Life business. During the quarter, we continued to take further actions to enhance returns, strengthen our platforms and pursue targeted growth opportunities.

Turning to Individual Retirement on Slide 13. Uncertainties surrounding the impact and implementation of the Department of Labor fiduciary rule as well as potential delays and possible modifications to the rule have continued to significantly affect distributors, negatively impacting industry sales, in particular

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annuity products. The impact from our distributors' focus on implementing the DOL rule, along with more aggressive competition in the fixed annuity space, led to materially lower Individual Retirement sales and net flows from a year ago. In the face of industry challenges, we continued our disciplined approach with respect to product pricing, product features and asset quality and continue to benefit from our broad product portfolio and diversified distribution network. Net spreads remained strong but are not immune to the low rate environment while increases in policy fee income reflect tailwinds from robust equity markets.

Turning to Group Retirement on Page 14. Our investments in VALIC to transform the plan sponsor and participant experience continued to pay off. Deposits decreased slightly for the quarter but are up year-to-date, primarily due to increased new group acquisitions, which remain at a very high level. Net flows declined for the quarter and year-to-date due to the timing of group surrenders. Also despite disciplined rate management, net investment spreads declined due to the runoff of higher-yielding assets and reinvestments in the low-yield environment. Looking forward, across Individual and Group Retirement, absent significant changes in the overall rate environment, we continue to expect our net spreads will decline by approximately 1 to 3 basis points per quarter.

Before moving on to Life, let me say a few words about the DOL fiduciary rule. We believe that we implemented the system changes and processes necessary to achieve compliance with the provisions of the rule that became effective on June 9. We are also on track for full compliance on January 1 while closely following the DOL's ongoing review and assessment of the rule. We are in constant communication with our distribution partners through this complex transition to ensure that we can continue to meet their evolving needs.

Let's now move to Life Insurance on Slide 15. Our Life Insurance business continued to make progress, executing our plans to enhance ROE and return to growth. We have now transitioned the bulk of our new business processing to our modern administrative platforms and have outsourced administration of our Legacy portfolios, allowing us to focus on current new business and further improve operating efficiencies. In the U.S., premiums and deposits increased and we have strong growth in both term and universal life insurance sales. Also overall mortality experience continued within pricing expectations.

Turning to Slide 16. Personal Insurance produced very strong results this quarter. The significant increase in PTOI was driven by an unusually low level of loss activity, including no severe losses and minimal catastrophe losses, strategic actions to reduce expenses and higher net investment income. Our Personal Insurance results reflect our focus in markets and customer segments, where we have a competitive advantage and favorable growth prospects. We are executing on a number of unique partnership arrangements and expanding our multinational offerings. While this quarter represented unusually favorable experience in Personal Insurance, we are moving our focus from margin expansion to growth at targeted margins.

Finally, in Japan, we continue to make progress in our transformation while producing strong operating results. We are successfully conducting business under FSA-approved premerger status and remain on track for the legal entity merger on January 1, 2018. During the quarter, we also completed the sale of AIG Fuji Life, allowing us to focus on our strong P&C position going forward.

To close, I'm pleased with Consumer's results this quarter and the progress we are making across our business. Now I would like to turn it back to Liz to open up to Q&A.

Elizabeth A. Werner
Head of Investor Relations and Vice President
Anthony, could we open up the lines for Q&A now?

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Question and Answer

Operator

[Operator Instructions] Our first question comes from Kai Pan with Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

First, congrats to both Brian and Peter for your new positions. My first question is on reserve. You took another like $400 million of gross charges like before the reinsurance recoverable. I'm wondering, Brian, because you started as actuary in AIG many years ago, what's your reserving philosophy? And do you see we will continue in the near term to see some slow bleeding in terms of reserve charges or another sort of kitchen sink quarter in the fourth quarter?

Brian Duperreault
CEO, President & Director

Kai, thanks for the congratulations to start with, and thanks for reminding me I was an actuary at this company once. Look, reserves, you have to be realistic. You've got to be conservative. You have to take facts on when they come in that change your opinion about it. And you have to have a consistent approach to your process. So what I have seen is a process that I mentioned in my remarks as sound. I think the positions we're taking are reasonable. I think there's a conservatism in their approach. But that doesn't mean that you can't have movements, both up and down in old years. But what I have seen in this quarter doesn't give me pause. It doesn't increase my anxiety about anything. I think it's -- the process has been reasonable and there are some movements. But as I said earlier, I think the current years are put in a reasonable position, even though the green, I think they're reasonable, didn't have much activity there. That's probably all I'd say about it.

Kai Pan
Morgan Stanley, Research Division

My follow-ups is -- yes, if I may, on capital management. You said you would take a more balanced approach. You no longer give sort of any target for annual buybacks. I'm wondering, what's the balance between buyback -- in your mind, between buybacks and the investments? And how do you value the return on buybacks buying at below your book value versus potential growth opportunities out there?

Brian Duperreault
CEO, President & Director

Thanks, Kai. Yes, so look, buybacks, that's a capital management tool. It's not a strategy, it's not a growth strategy in particular. And so if you set yourself as a company that grows and increases its profits over time in a sustainable way and developing franchise value, then you have to take that capital that you're getting every quarter and deploying it. So that means that a buyback process has to be blended in with deploying the capital in some ways that gives you a long-term value. So that's what we do. I mean, we've got the capital. As management in this company, we've been given that responsibility in charge to do the best with it to create long-term shareholder value. And as I said, my priority is to take this capital and find ways where we can increase the franchise value of this company. If we can't, obviously we would return it. But that would be something I would prefer not to do if I can find something better to use it for, okay? Good.

Operator

Our next question comes from Ryan Tunis with Crédit Suisse.

Ryan James Tunis
Crédit Suisse AG, Research Division

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I had a question, and then John Nadel had a follow-up. But I guess my question is just in terms of the improvement in P&C. How long should we expect this to take? I think you mentioned that some of the problematic lines are Property. I would imagine that those are a little bit faster to fix and some Casualty lines. And where should we see the improvements? Should it be more on the expense ratio side or on the loss ratio side?

Brian Duperreault
CEO, President & Director

Okay. Well, look, that's always a great question. It's like how long is a piece of string? It takes some time in certain lines, it takes longer in some than others and you pointed that out. They've been working on the Casualty for some time. Looking at [quality] work that's been done here frankly. I mean, it's not easy to do what they've done. And I like the fact that they've been intellectually honest with themselves about what's good and what's not good here. And that's terrific. I mean, that's another hallmark of a great company. So this Casualty business, it takes time to earn out. It takes time to yield its secrets. Those things are revolving. I think a lot of that work has been done. But as I said in my remarks, there's still some of those positions that we have, they're still not producing a good result. And this market is not going to let us fix it through price, terms and conditions, not going to let us. So that means it's selection and that means reduction probably. So if you reduce, you're going to have that premium earn-out over time. So you're just going to let that -- you're just going to have to let that play out, you have to watch us, continue to deploy the discipline that has been deployed. Property is usually a little easier to fix. I mean, you can see the results quicker because it's really the last couple of years of activity that's going to be affected. There are some idiosyncrasies in the Property book that takes that a little bit longer, like this 1/1 renewal in Europe as an example, maybe we've just got some multiline businesses. Yes, so where do you see it? Okay, if I reduce business, if we stop writing premiums, the loss ratio would go down, your expense ratio is going to go up, okay? Net-net, you're better off. So that's why I said don't put -- don't force me to give you an expense number and the loss ratio number because it's a very complicated, nuanced process. If the property is going to be attacked, your loss ratio is probably going to go up because property tends to have lower loss ratios. And I think that's occurred already in the portfolio management that Rob has been doing. It's going to continue. So what we're trying to do is make an underwriting profit. And that's a combination of those 2. And they're going to be in balance. And that's really what you have to look for. Are we improving the underwriting profit of this company? And that's the real indicator. You've got a follow-up?

John Matthew Nadel
Crédit Suisse AG, Research Division

Yes, this is John Nadel. I think it probably comes as little surprise to most folks who've known you for most of your career that you talk about an interest in inorganic growth on the Property Casualty side. But I was curious about your comment about some interest on the Life Insurance side. It seems to me in an environment where you could actually monetize pieces of the Life portfolio at very high levels, given some irrational exuberance maybe in long-term or long-dated liabilities, I'm just curious as you think about how to bolster either strategically or directionally the Life side of the portfolio. What areas geographically or product sets might you be interested in?

Brian Duperreault
CEO, President & Director

Well, I'm going to start this. But I might ask Kevin to help me out here, all right? But I think if you look at the Life business we have, it is localized. It is substantially the U.S. But in the U.S., it's quite balanced. We've got a nice balance in what we describe as Life. So my philosophy is always that balance is a wonderful thing because you can shift from one to the other as markets present themselves. So if I'm, and I am, after more balance, I think the Life business needs to be expanded outside the U.S. But it should have the same characteristics as we do in the U.S. Now Kevin, do you want to add to that?

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

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Yes, sure. John, first of all, just as a reminder, we have a very unique position in the United States. In the Individual Retirement space, we're a major player in all 3 of the relevant products, variable, indexed and fixed annuities. And there's a little uncertainty in the market right now. But there's going to be a new normal that emerges after the regulatory environment settles out and distributors understand how to respond. And nobody is better positioned than we are to be able to serve the needs of that market. And the Group Retirement business is also a business that is extremely well positioned for us. We're in the top 3 position in the major segments of K-12, upper education and health care, that our focus is there. So there's tremendous franchise value in these businesses and the spectrum of the entire retirement space that we participate in. And in our Life business, we've worked in the last couple of years to dramatically evolve our distribution. And our new business is back to the quality that we expect and it's growing quite robustly at this point. We have the opportunity to expand outside the United States in attractive markets according to where our skill sets are and where the opportunities are. And a few years ago, we made a small acquisition in the U.K. as example, but it's actually doing very well. When we started with that business, it was entirely in the independent financial adviser space. We just expanded to our first bank partnership with the Royal Bank of Scotland, a program we just launched in the last couple of weeks. And we see a lot of upside with that business, which is a very attractive, albeit relatively modest-sized business. And there are plenty of other opportunities for us in various places around the world. We don't provide direction in terms of specifics, but we're certainly in a position to evaluate entering into markets which are attractive, which have appropriate legal and structural foundations and which are growth opportunities for us in the medium and long term.

Operator

Our next question comes from Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

I had a couple of questions broadly related to things that have already been addressed but just a little bit more detail. First, just for Brian, on your comfort with loss picks and reserves. I'm just a little surprised, just wondering whether you're basing your views on detailed analysis of reserves or just a preliminary look. Because for the past several years, management has been ensuring investors that the company is becoming more conservative at risk selection, more conservative in setting loss picks. But we've seen continued adverse development, even on recently sold business. And then secondly, on M&A, are there any specific -- you mentioned what you're interested in. Are there any specific financial targets besides just being a good strategic fit that the deals would have to meet for you to be -- for you to execute on them?

Brian Duperreault
CEO, President & Director

Okay. Well, it's a -- yes, the reserves. Look, I can understand your questions around reserves. Look, I'm not the actuary here. So I'm not going to go through the details that the actuaries would do or the finance departments would do. But I am knowledgeable about the business and the process. And so I spend a lot of time with them understanding how they do it, what they do, what their assumptions are, what the discipline is around the process, how they get their data. And I think what they are doing is sound. And I can't really comment on what happened before. I can only look at what we're doing now. And as I said, I think it's reasonable and sound. As far as M&A is concerned, yes, look, I like accretion. Who doesn't? I mean, I think things should be accretive. They should start with being strategic. We don't want to double down on things we already do. We want to balance what we're doing with other things. So I'm going to be primarily looking for strategic balance that gives us ways to deploy capital when the things we do have issues. Accretion is -- it's a wonderful thing. Financially, you'd like to see it improve your profit short term. But you're certainly better at making -- improve the profits long term. But I also like accretion in terms of people, capabilities and spread. And so that accretion has to be more than just a number. It can't just be the profit, better give us a whole lot more capability than we have now.

Operator

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Our next question comes from Jay Gelb with Barclays.

Jay H. Gelb
Barclays PLC, Research Division

On the merger and acquisition front, could you give us some perspective on whether you're looking more for bolt-on-sized acquisitions or perhaps something larger or transformational?

Brian Duperreault
CEO, President & Director

Well, Jay, look, if I can find something transformational, who wouldn't do that? Playing the odds, the more likely scenario are things that are smaller than what might be described as transformational. Yes, I wouldn't mind doing both, so -- but if you're playing the odds, you've got a better chance of doing a series of acquisitions than one large one. We'll see what happens.

Jay H. Gelb
Barclays PLC, Research Division

That's helpful. And then my follow-up on capital management is I know you're not giving targets or guidance, but in the scope of share buybacks, should we think of a small fraction of annual earnings as something earmarked for buybacks in absence of being able to deploy it in other opportunities?

Brian Duperreault
CEO, President & Director

Well, Jay, if I said I'm not going to give you guidance, I'm not going to give you guidance. So let's leave it at that, but thanks for the question.

Operator

Our next question comes from Tom Gallagher with Evercore ISI.

Thomas George Gallagher
Evercore ISI, Research Division

Brian, I know it's early in your tenure there. But just as you're evaluating things, you look at results in the Commercial business, why do you think AIG has underperformed peers by so much? Is it the right strategy, just not enough reserves? Is it too much growth in Property? Does something need to be changed with the execution or the strategy? Pretty broad question, but just curious what your evaluation is there.

Brian Duperreault
CEO, President & Director

Thanks, Tom. I guess I could give you a very detailed, expansive discussion about all the parts that could cause this. But I'd say in its simplest form, if you're going to outperform the market, you need some maneuverability in that. And I think we've got to be a very, very large player, particularly in the large commercial space, such that there really wasn't a lot of room to maneuver, and therefore, your ability to select goes down, your ability to get price that you want goes down. So what I've seen them doing is the intelligent thing, which is to cut back on those areas where they didn't select with the same professionalism or didn't price with the same professionalism. That naturally produces a smaller book of business. But that book of business should be sound. And the underwriting process around it should be sound going forward. And that drives the need to redefine what Commercial is. So it's not just the largest of the large risk, but it's a balance of the full gamut of Commercial business, particularly in the United States.

Thomas George Gallagher
Evercore ISI, Research Division

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Got you. And then just as a follow-up, you said that $16 billion of reserves that were reviewed this quarter were related to some of the more challenging lines. Would it be fair to say that in response to evaluation of reserves from the time you joined through into the future that you feel like that was the hardest part, that you'd feel pretty good overall about the reserves? I should think about balance sheet risk in aggregate? Or is there still more wood to chop with evaluation of reserves?

Brian Duperreault
CEO, President & Director

Well, look, I think you have to have a disciplined process around this, save everything to the last quarter. So they chose these. They chose, I think, wisely because of the were some of the more challenging lines, as I said. That doesn't mean that there isn't a review of the entire portfolio. It just means that there is an in-depth review in 1 quarter of a certain segment. But you are looking at all of them because have to set all the reserves. And so as we look at the rest of the portfolio, there wasn't anything that would have caused us enough concern to do an earlier in-depth review, let's put it that way. But we'll see what happens in the third quarter. But I think I would take that as some comfort.

Operator

Our next question comes from Paul Newsome with Sandler O'Neill.

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

I was wondering if we could maybe just kind of review where you did end up at the end of the day relative to the old target of the capital return and such throughout the period. I realize it's not prospectively what you're focused on. But I think some general thoughts as to whether or not you think this thing is ultimately successful -- in the regional strategy is ultimately successful?

Brian Duperreault
CEO, President & Director

Yes, well, hey, Sid, why don't you answer that question?

Siddhartha Sankaran
Executive VP & CFO

Thank you, Brian. Paul, as I said in our remarks, we've returned over $20 billion of capital in the past 18 months with the announcement of our dividend. So we've done that. And the most important thing that we've alluded to here is we have an extremely strong balance sheet and are well positioned for the future. So $7.8 billion of parent liquidity and extremely good cash flow projection. So I think I can leave it at that.

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

And a follow-up, yes, I'm thinking of capital allocation prospectively. Am I right to think that we should end up with more capital allocation towards the Life businesses in general? And maybe you could talk a little bit about that.

Brian Duperreault
CEO, President & Director

Well, I think this is -- it's a great question. I mean, if the Life business was going to be the area where we felt we have the strongest chance of delivering superior returns, and by the way, they're doing pretty well, then the answer would be yes. I think everybody is presenting me with ideas about where we could deploy it. And the best story wins.

Operator

Our next question comes from Meyer Shields with KBW.

Meyer Shields

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Keefe, Bruyette, & Woods, Inc., Research Division

I think my first question is for Rob. I'm just trying to understand, given the cutting of so much really, really bad business in Commercial, why we didn't see improvements in the underlying accident loss ratio in financial and liability.

Robert S. Schimek
Executive VP & CEO of Commercial

What I wanted to emphasize within Liability and Financial Lines is that we've had a lot of efforts to improve our risk selection and business mix and reduce the reserve volatility. And just remember, we've achieved an 11.3% ROE this quarter. And so first thing I would say is if you just pause on that, we believe that we've got a clear path to an ongoing double-digit ROE, which is sustainable. And that's really reflecting the quality of the mix of business that we've achieved. I think we had a great quarter with respect to Special Risks, as I mentioned. So actually, Q2, our return there was even better than Liabilities or Financial Lines. And so it really brings you back to Property. And I think Brian talked a bit about that. I think what I would emphasize for you is there's really 3 elements to us for Property. We've done a very good job of managing our cat exposure both with improved modeling, risk selection and use of reinsurance. Our severe losses as a percentage of the premiums that we're earning in Property and Special Risks have continued to come down year-over-year. And that leaves us with improving the attritional loss ratio in the Property book. And as Brian mentioned, in particular, we've got our sights set on Northern Europe. But there's timing issues associated with when you can actually make those moves. So just to put it in context for you, 55% of our Property book in Continental Europe renews on January 1. So the next bite at the apple is not until January 1, 2018. And the 2 most challenged countries in Northern Europe are Denmark and Germany and 70% of their book renews on January 1. So there's just structural impediments to being able to move it faster. But if you asked about the confidence in the actions that we have taken, I'm completely confident that we've been taking the right actions to achieve the results.

Brian Duperreault
CEO, President & Director

I might add that, look, it's a very competitive market. So you can have a very nice piece of business portfolio today. And then it's attacked in price, terms and conditions, and you've got to react to it. So it's a constant fight. But this isn't the kind of market where you can just go out and write a whole bunch of new business and declare success. So I think Rob is fighting the pressures of the market at the same time to continue to keep his liability business, in particular, in a position to returning those good returns on equity. Do you have a follow-up?

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Yes. Just a quick one, Brian. You mentioned in your introductory comments, and I think you're right, that AIG no longer should qualify for nonbank SIFI status. Can you talk about what that would imply if that definition was moved?

Brian Duperreault
CEO, President & Director

Well, it would imply we wouldn't have the Fed as a regulator and we would be regulated again by the states. And we're still regulated by the states. So we would lose the Fed as the group supervisor, simple as that.

Operator

Our next question comes from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

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Welcome back, Brian. First question is how long do you think it takes to get the platform in the Commercial line space, Brian, to where you'd be comfortable in kind of growing organically profitably?

Brian Duperreault
CEO, President & Director

By the way, thanks. It's nice to be back, Brian. Well, the Commercial book is -- it isn't just one thing, right? So you heard from Rob that the Specialty business has been performing well and the financial -- or the financial and liabilities performing well. And so those are areas that we look to expand and grow because the market and, let's say, our professionalism allows us to do that. In some of the Casualty business, I just don't see it. I really don't see it. And Property is a mixed bag. Property is a mixed bag because there are some things that, like in Europe, that we should be doing. We'll be doing those both to improve the book and business that we can go after and attack in a greater way. So it's a broad front kind of business. And again, it's concentrated at the high end. So the other thing is to get into kind of down the risk chain as well and expand into that area.

Brian Robert Meredith
UBS Investment Bank, Research Division

Yes. And going down the risk chain, that was my next question for you. Do you have the distribution relationships to kind of go down that risk chain right now? And is the platform there to go down? Or is there some build-out that still needs...

Brian Duperreault
CEO, President & Director

Yes. No, the answer is not really. It hasn't been an area that AIG has done well over time. And so we don't have the classic distribution channels for small business. Now we have Seraina, who's sitting here with us right now, developing a portfolio of business and a technology around it, which would go after that business but in a way where we would develop to technology the kind of distribution we would need. So that's at the lower end of that business. We have Rob at the higher end of the business. And we do play to some degree in that. And that tends to then match our existing distribution channels, where the business is on the larger end of the middle market or it's business that has certain characteristic in terms of its risk profile or maybe it's not a large sales or a large employee population company, but it has certain characteristics that naturally fit our skill set. So Rob will be working that area stronger. Seraina will be working her area stronger. And we'll see what else happens.

Operator

Our next question comes from Jay Cohen with Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Just I guess maybe one last try at this capital management topic. Brian, should we expect an outright pause in buybacks in the near term as you start to build up capital?

Brian Duperreault
CEO, President & Director

I love this, this is great, Jay. Thanks a lot. Okay, so I think I've said it already. Look, let's just do it in probabilities, right? The chances that we will be buying at the levels that we've been buying are very low. Let's just put it that way. But that doesn't mean we won't necessarily use that tool. What Sid said, it's a tool. And you use the tool opportunistically. So if I see that it is the right thing to do and the opportunity is there for us, I will deploy the tool.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

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Okay, understood. A second question maybe for Rob, maybe for you. On the Commercial side, it sounds as if the premium declines are now likely to continue. And that makes sense. Will you have to take another stab at expenses as well just to defend, to some extent, the expense ratio?

Brian Duperreault
CEO, President & Director

Well, let me answer that. And I said it earlier, look, expense discipline is a way of life. I mean, if you don't have -- if you're not running your company -- it's one of your levers. If you're not running the company with attention to your expenses in this kind of market, and this is usually the kind of market we're in, then you're going to fail eventually. So yes, expense will continue to be something we will look at all the time. But I want to emphasize that we will spend money, too. And if we have a rising expense ratio but an improving bottom line, I'll be a happy guy, too. So I want to put it, it is a balanced situation, where we will continue to reduce our cost because our cost structure are high, but we're going to invest in the areas that, one, will help us or bring people in that get us to growth area. And if I had to choose between reducing the volume because it's not producing a profit but that would cause the expenses to go up, I'm going to make that choice all day long.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, operator. We appreciate you joining our call this morning. We know you have a lot of calls. So with that, I think we'll call it a day and would look forward to following up with you on any additional questions.

Brian Duperreault
CEO, President & Director

And look, I want to just thank all the people in AIG for a great work.

Operator
That does conclude today's conference. Thank you for your participation.

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