S&P Capital IQ

CONTENTS

American International Group, Inc. NYSE:AIG

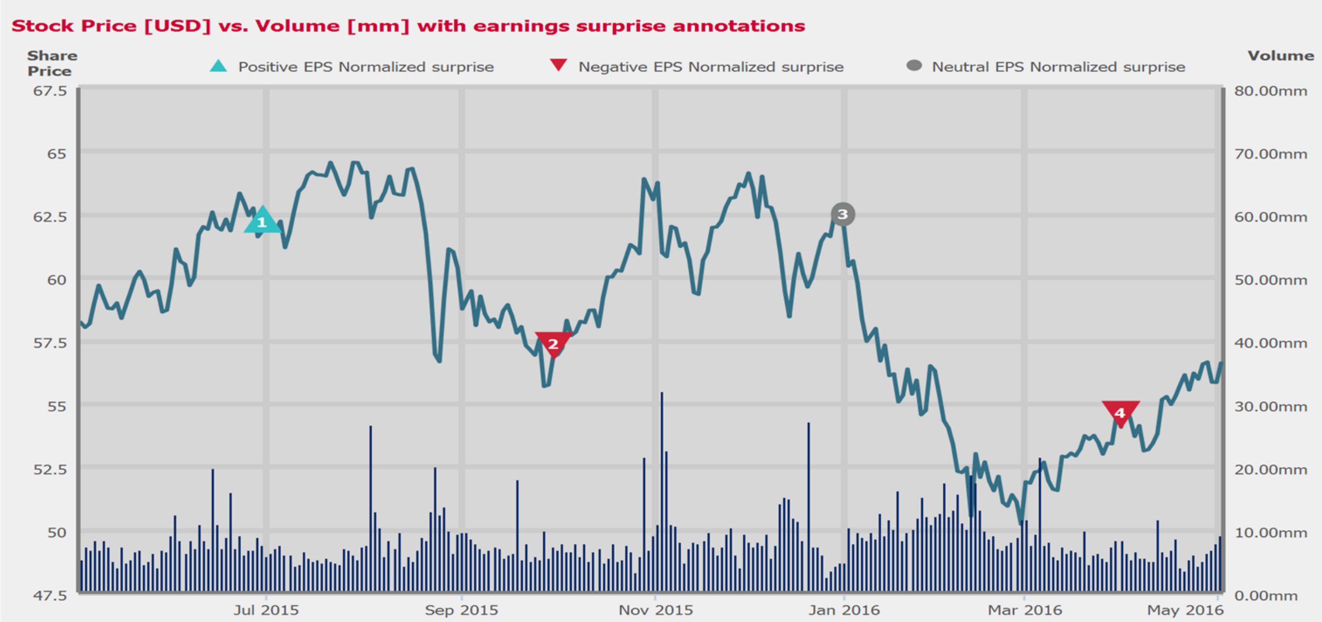
FQ2 2016 Earnings Call Transcripts

Wednesday, August 03, 2016 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2016-			-FQ3 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.94	0.98	▲4.26	1.17	3.98	5.51
Revenue (mm)	13688.00	14724.00	▲7.57	13036.76	50874.09	50701.33

Currency: USD
Consensus as of Aug-03-2016 12:21 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2015	1.22	1.39	▲13.93 %
FQ3 2015	1.01	0.52	▼(48.51 %)
FQ4 2015	(0.93)	(1.10)	NM
FQ1 2016	1.00	0.65	▼(35.00 %)

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

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Presentation

Operator

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

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, Lauren. 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 that 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 2015 Form 10-K under Management's Discussion and Analysis of Financial Conditions and Results of Operations under Risk Factors. AIG is not under any obligation and expressly disclaims any obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

Today's presentation may contain non-GAAP financial measures. The reconciliation of such measures to the most comparable GAAP figures is included in the slides for today's presentation and in our financial supplement, both of which are available on our website. Nothing in today's presentation or in any oral statement made in connection with this presentation is intended to constitute nor shall it deem to constitute any offer of any securities for sale or the solicitation of an offer to purchase any securities in any jurisdiction. [Operator Instructions]

With that, I would like to turn it over to our speakers today. We have our CEO, Peter Hancock; our CFO, Sid Sankaran; and many others in the room, including our Head of Commercial, Rob Schimek; and the Head of Consumer, Kevin Hogan.

And with that, Peter, I'll turn it to you.

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

Thank you, Liz, and good morning, everyone. This morning, I'll speak briefly to our performance this quarter as well as our outlook and ongoing transformation. AIG's second quarter results show strong improvement towards all the goals the board and I announced in January. We've executed more quickly and smoothly than expected, and our confidence in reaching our 2017 financial targets is high as our earnings become more sustainable.

In the second quarter, we continued to execute and delivered strong operating earnings of $0.98 per share, including a $0.17 charge from the workers' compensation discount, which Sid will discuss. Adjusted Commercial Insurance underwriting improved again this quarter, which Rob will speak to. Consumers' expense discipline also resulted in increased profitability, particularly in Personal Insurance, and Kevin will address this in his remarks.

Across AIG, we are simplifying the company, accelerating our decision-making and adhering to a consistent management philosophy. We're executing on our objectives of managing our core operating portfolios to increase return on equity and managing our Legacy Portfolio for capital return. As we had previously announced, Charlie Shamieh is leading a team focused on our Legacy Portfolio and is actively moving forward.

Our managerial discipline across AIG is based on a guiding principle of building economic value, which is consistently applied throughout the company. We frequently discuss our focus on value over volume when speaking to Commercial underwriting and the value of new business for Consumer businesses. The flexibility we have earned by focusing on expense discipline and growth in segments with sustainable value has allowed us to maintain positive operating leverage, while we have reduced our top line aggressively.

Normalized ROE was 8.8% for both the quarter and the first 6 months of this year. Our operating improvements and return of capital will continue to positively impact ROE and was solidly on track to deliver full year normalized ROE in our targeted range of 8.4% to 8.9%. As a reminder, our third quarter normalized ROE will reflect a higher level of expected catastrophe losses. Book value per share, excluding AOCI and DTA and including dividend growth, increased 5% in the quarter and we continue to expect to achieve double-digit growth for the full year.

Our confidence in the future is based on our focus on what we can control. Our active value management framework for capital allocation and product design allows us to navigate through volatile markets. At this time, AIG's transformation to a more efficient and nimble organization is more important than ever. We anticipate and address challenges such as sustained low interest rates, Brexit and other market forces across our strategies. Sid will follow my remarks with greater transparency on the impact of low interest rates specifically. In the case of Brexit, we believe we're well positioned given our branch structure. It may be sometime before the requirements associated with Brexit are known and any potential economic impact from Brexit materializes. We're positioning AIG for changing economic, political and regulatory environments and for future earnings sustainability.

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

Siddhartha Sankaran
Executive VP & CFO

Thank you, Peter, and good morning, everyone. This morning, I'll speak to our quarterly financial results, including notable items. I'll also discuss the impact of the current interest rate environment and close with comments on capital management.

Turning to Slide 4. Our core operating earnings showed good progress this quarter with strong underwriting results, particularly with respect to the Commercial accident year loss ratio as adjusted and expense discipline across AIG. In addition, UGC delivered another quarter of solid results, driven by improved loss experience and growth in net premiums earned.

Our year-on-year comparisons were impacted by 4 items of note. First, the workers' compensation discount amounted to a $300 million charge this quarter versus a $400 million benefit. The workers' compensation discount rate adjustments are recorded in earnings, while offsetting changes in the fair value of securities backing these liabilities are recorded to AOCI. This results in minimal impact to reported book value. Accordingly, when we report on normalized ROE, we remove this noneconomic change in net reserve discount. A 25 basis point change in the discount rate, which is comprised of the U.S. Treasury rate plus an assumed credit spread, has roughly $100 million to $125 million pretax impact on reported earnings.

The second item was a modest $29 million of overall net unfavorable prior year reserve development compared to a net unfavorable development of $329 million a year ago. Included in the quarter was $109 million strengthening of Florida workers' compensation reserves, partially offset by favorable reserve development in Property and Specialty lines. The Florida workers' compensation reserve increase was due to recent industry-wide Florida court rulings, which occurred during the quarter. The judgments created an increased liability for previous years, which made a reserve increase in this segment prudent. AIG has a 5% market share in Florida and an average market share of 8% for the past 10- and 15-year periods. The third item was that Q2 was our highest natural catastrophe quarter since Hurricane Sandy in 2012. We had higher CAT losses in the quarter of $414 million compared to the roughly in line level of the $225 million in catastrophes for the prior year.

The final item was the meaningful change in market-sensitive asset returns as shown on Slide 5. Overall, the impact of last year's outsized Q2 returns and our actions to reduce market-sensitive assets resulted in approximately $1 billion decline in mark-to-market income versus a year ago. However, of note in the quarter, these assets contributed just under $300 million to income, which was close to our expectation.

Our steps to reduce market exposure will allow for more sustainable and less volatile earnings going forward. Since 2010, our market-sensitive assets have declined by over 40% or by $19 billion.

Turning to Slide 6. We've provided an overview of the impact interest rates may have on our in-force as well as on new business for key portfolios. With respect to the in-force, we have a strong discipline around asset liability management led by our Chief Investment Officer, Doug Dachille. We see limited in-force impact on long-tail casualty, where assets are slightly longer than liabilities and on variable annuities, where in 2014 we made a decision to fully hedge the interest rate risk on living benefits, which is accounted for at fair value.

On Fixed Annuities, approximately 72% of the book is already at guaranteed minimum crediting rates. The sustained low rates may reduce to lenders and we see potential spread compression from declining portfolio yields. We're projecting a 2 to 4 basis point quarterly decline in net spreads. For our Life business and legacy structured settlements, while we're exposed to some potential ALM mismatch on the long end of the curve due to limited investable assets, its impact on earnings in the next few years is modest, although it will grow somewhat over a very long time horizon with reinvestment.

On new business, we maintained a continued focus on pricing, product design and risk management across AIG. We expect some ROE compression in long-tail casualty. However, we continue to push on pricing and risk selection. For our annuity businesses, we expect the primary impact to be a decline in volumes as we frequently reevaluate our products to ensure that we're meeting our return targets.

Considering both the in-force and new business, we're presenting a scenario to illustrate the potential headwinds to our January 26 stated targets from the current environment. The 2017 average 10-year treasury rate assumption that was used in our plan was 2.6%. Assuming interest rates are 100 basis points lower than our original 2.6% assumption, we would anticipate a potential 25 to 35 basis point reduction in 2017 normalized ROE based on a decline in normalized pretax operating income of $250 million to $350 million. However, if rates were to move steadily higher from the levels today back to our initial projection, we would not expect this impact to materialize.

Also, as Peter said, our guiding philosophy is around managing to economic value. Since year-end, we estimate the decline in interest rate and markets has impacted our estimate of intrinsic value by approximately 5%. Despite the challenging interest rate environment, we remain committed our stated targets. We believe that our ability to manage our expense and capital structures we will discuss where we are ahead plan give us the ability to withstand potential 2017 earnings pressures.

Turning to Slide 7. We've executed against our plan and have reduced operating expenses by 11% year-to-date on a constant dollar basis. While the pace of this improvement should slow in the second half of the year, we expect to exceed the 6% targeted GOE decline for the full year. Our expense reduction targets are carefully aligned against our projections of new business volumes to meet our objective of improving operating leverage.

Slide 8 shows the expansion of our second quarter normalized ROE to 8.8%. This improvement reflected almost $15 billion of capital return to shareholders since the second quarter of 2015, as well as continued improvement in normalized operating results.

Slide 9 shows a strong growth in book value, driven by earnings, realized capital gains, our estimated DTA utilization and accretive share repurchases during the quarter.

Turning to capital on Slide 10. We continue to execute against our $25 billion capital return target and have returned $7.2 billion of capital to shareholders in the first half of the year. During the quarter, we deployed about $2.8 billion towards the purchase of 50 million common shares, and we also repurchased 5 million of our outstanding warrants for $90 million. Since quarter end and through August 2, we repurchased an additional $698 million of common shares. Our remaining authorization stands at approximately $4 billion, including the new $3 billion authorization announced yesterday. Our balance sheet remains very strong with $6.7 billion of parent liquidity, a financial leverage ratio below 20% and RBC and rating agency capital ratios that continue to remain within our targets.

With respect to the key levers funding our capital return target, free cash flow continued to be strong in the second quarter, as shown on Slide 11. We announced that we would reduce our hedge fund allocation by about half, which we expect would free up $2 billion of capital towards our capital return target by the end of 2017. Submitted notices of redemption are $4.2 billion, and through the second quarter, proceeds have freed up approximately $400 million in capital in our life companies, which have caught up to the holding company in the form of dividend payments. Additionally, distributions from the life companies during the quarter included $315 million from the sale of AIG Advisor Group.

We continue to make solid progress on monetizing legacy assets, with $4.3 billion of total free cash flow generated over the last 3 quarters. During the quarter, the holding company recognized $500 million of proceeds, largely from the sale of the PICC Group stake held at parent to the nonlife companies. We have completed the majority of encumbered asset dispositions or transferred outlined in our January 26 strategic plan as of the end of the second quarter. Charlie Shamieh and his team are focused on the disposition process going forward for many of the insurance liabilities in Legacy, which we have kicked off for several portfolios. It is important to note that some of the legacy insurance portfolios will have more extended time frames for exit. We'll provide further disclosure at year-end with our modular segment reporting for Legacy and provide additional information on a timely basis as we close any material transactions that are in progress. As Peter stated, we're focused on continued execution of our strategic plan that we first outlined in January and providing you with additional disclosure as we progress throughout 2016.

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

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

Thank you, Sid, and good morning, everyone. Commercial had a strong second quarter despite the backdrop of a generally soft market. Today, I'll discuss how the execution of our strategic plan is improving Commercial's mix of business and creating a leaner, more focused and profitable organization. We're committed to making economic-based decisions, while we remain true to our vision of being our clients' most valued insurer.

Turning to Slide 13. Commercial's adjusted accident year loss ratio of 62.4% improved 4.2 points from the prior year quarter with 3.4 points related to the strategic actions we announced in January and 0.8 points attributable to a lower level of severe losses. We reduced second quarter net premium writings by 20% after adjusting for foreign exchange as part of reshaping of the portfolio. About half of the change was driven by increasing our use of reinsurance, the targeted exits we communicated in the first quarter and market headwinds from lower rates. The vast majority of the other half was attributable to underwriting actions and poorer performing subsegments of Casualty and Property. These actions included addressing unprofitable single or 2-product client relationships and micro-segmentation and re-underwriting of risks using enhanced analytic tools. As always, we make underwriting decisions initially on a product basis and then on a client-by-client basis, taking a holistic view across each client relationship. We've placed the priority on limiting disruption for our clients and broker partners and preserving the strength of our valued multiline client relationships. Retention for our major clients remains very healthy at about 94% on a year-to-date basis.

Our objective is to deploy our capital in higher-performing subsegments where we earn our target rate of return. The market is practicing less restraint and we've taken advantage of the opportunity to shed underperforming and highly commoditized businesses, while having the flexibility to retain more attractive risks with the same clients. As a result of the pace of our actions and underwriting discipline, we're updating our 2016 full year estimates to reflect us managing net premiums written down by a total of approximately $3 billion in 2016 as we seek to optimize our portfolio.

Globally, rates were down about 1 point, reflecting competitive international conditions, while overall rates in the U.S. were about flat. U.S. Casualty rates continued their positive trend, increasing over 4.5 points and rates were up 2 points in our Specialty businesses. Partially offsetting those increases, we continued to observe pressure in the excess and surplus lines Property business and we saw more aggressive pricing in Financial Lines where rates decreased about 2%.

I'm pleased to say that during the first half of 2016, we recorded double-digit growth in several lines where we are a market leader and offer a compelling value proposition including M&A, middle-market property, cyber and credit lines. In addition, multinational programs increased by approximately 9%, demonstrating our enduring advantage in this important client segment, and we continue to experience growth in large limit property. We're placing emphasis on investing in analytics and engineering capabilities to offer our clients unique data-driven insights that go beyond traditional risk transfer capabilities.

Switching gears to expenses. I'm happy to share that our GOE ratio improved 1.2 points in the quarter as a result of AIG's expense initiatives. We expected expenses will continue to decline, although at a more modest pace in the second half of the year. The GOE ratio will likely trend slightly upward from its current level as the impact of our lower written premiums earn in during the remainder of 2016 and 2017. With that said, we're proud that the improvements in our loss ratio are not expected to be significantly offset by deterioration of our expense ratio.

Slide 14 shows the continued improvement in Commercial's adjusted accident year loss ratio between 2011 and the second quarter of 2016, including the effect of 2012 through 2015 prior period development in each accident year. The second quarter result of 62.4% represents a 3.8 point improvement over the full year of 2015, reflecting the impact of our strategic initiatives to improve the loss ratio. Our team is doing a terrific job executing against our plan, and we received excellent support from our clients and broker partners who recognize the value of a strong AIG standing by their side.

We remain confident that we will reach our previously announced 62% exit run rate target for 2016. As we've stated in the past, we do not expect our progress to be linear, notwithstanding this quarter's performance in the low level of severe losses, our results are subject to volatility, particularly in Property. Late in the quarter, we put in place a focused reinsurance agreement for classes of business that have generated the greatest volatility in our international Property business. We're also pleased that we've been able to avoid several recent notable losses in Property as a result of our engineering and risk selection capabilities. These actions should dampen the past volatility we've experienced, but we will continue to have a degree of exposure to risks that are difficult to predict.

Slide 15 is the same slide we provided last quarter, updated to show the change in our business mix and adjusted accident year loss ratio between 2015 and the first half of the 2016 using 3 business strategy groupings: grow, maintain or improve and remediate. I'll highlight 4 points. First, the business we want to grow and maintain has increased from half of our premiums in 2015 to 60% to premiums through the first half of 2016. The weighted average adjusted accident year loss ratio was an attractive 56% through the first 6 months of 2016, which is broadly in line with the full year 2015 result of 54%. During the quarter, we continued to focus on growing these highly profitable areas of the business and investing in its clients.

Second, the business we're remediating decreased from 15% of the portfolio in 2015 to 9% through the first 6 months of the year and the accident year loss ratio has improved from 91% in 2015 to 84% over that time. Our improvements are the result of the exits we announced in the first quarter and the fact that we've not been writing new business that falls in this worst-performing group.

Third, the business that we're seeking to improve declined from 35% of premiums in 2015 to 31% of premiums in the first half of 2016, while the accident year loss ratio improved 6 points from 73% to 67% over the time. Our client and risk selection strategies and expansion of reinsurance were the primary drivers of those changes.

Finally, collectively, the business that we're remediating and the business that we're improving declined from half of the portfolio in 2015 to 40% for the first 6 months of 2016, while the weighted average accident year loss ratio improved by 7 points from 79% to 72% over that time. As you can see from the slides, we've achieved significant improvement in the adjusted accident year loss ratio by truly transforming our portfolio.

In closing, the second quarter was marked by focus on our strongest performing businesses and most valued client relationships, while we continued to execute our strategic actions. The results are a testament to the commitment and pace with which we're implementing our plan, which provides me with the confidence that we will achieve the targets we've communicated.

With that, I'd like to 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. Despite a challenging economic and regulatory environment, Consumer Insurance pretty solid results for the quarter on an overall basis, reflecting the benefits of our diversified portfolio of Retirement, Life and Personal Insurance businesses. Before specifically addressing the results, I would like to briefly provide some context. We are pleased that the benefits from a number of our strategic initiatives are positively emerging in our results. For example, our focused strategy in Personal Insurance and investments we have been making in Japan have lowered our overall expense ratio while producing profitable premium growth in select areas, including our high-net-worth client group business.

In Group Retirement, the investments we've made to enhance both our plan sponsor service and participant experience are starting to pay off in both our acquisition and retention activities. For our U.S. Life business, we are realizing meaningful cost benefits from the consolidation of numerous policy administration and field compensation systems into modern common platforms.

Realizing these types of benefits from our strategic initiatives is particularly important as our businesses face various challenges associated with the economic and regulatory environment. In particular, industry variable annuity sales are being pressured due to volatile equity markets and uncertainty about the DOL fiduciary rule. We are confident we will be prepared in time for implementation of the DOL rule, and we remain in active discussions with our distribution partners as they determine their chosen paths for implementation, which we will in turn support.

The combination of our leading market positions across annuity product lines and our multichannel distribution network positions us well to respond to various market conditions and the regulatory landscapes. Also, recent actions we have taken in our U.S. retirement and life proprietary distribution channels make us more nimble with respect to changing market conditions. With the completion of the sale of AIG Advisor Group during the quarter, going forward, nearly 100% of our retail variable annuity sales will be from third-party independent distribution.

Separately, in January of this year, we substantially reduced our Life career distribution channel. Independent distribution accounted for 80% of our U.S. Life sales year-to-date. At this time, our main proprietary distribution channels are our valid financial advisers who play a key role in serving our Group Retirement plan sponsors and participants in our direct-to-consumer business, AIG Direct. Increasing our focus on independent distribution reduces our fixed cost burden and enables us to change emphasis on product sales according to opportunity as we maintain pricing discipline. Across our businesses, we are constantly looking for new opportunities to reduce costs and variabilize expenses.

Now I will briefly discuss the results for the quarter. Turning to Retirement on Slide 17, we saw 6% growth in Retirement sales from a year ago. Growth was led by Fixed Annuities, Retail Mutual Funds and Group Retirement, while variable annuity sales declined, reflecting industry challenges. Fixed Annuities sales rose significantly from the low levels in the prior year quarter, although sales and net flows declined sequentially, reflecting lower interest rates during the quarter as well as a more competitive market environment. We continue to maintain our fixed annuity pricing and asset quality disciplines.

Group Retirement benefited from higher deposits and lower surrenders, resulting in improved net flows. While these results reflect the investments we've made in the business, including our client-focused technology platform, competition in this space remains robust. While variable annuity sales and net flows have been impacted by the uncertainties surrounding the DOL rule and market volatility, we are maintaining our pricing and product discipline to navigate these uncertainties. These challenges validate our strategy of offering a broad portfolio of product solutions to meet our clients' needs.

As you can see on Slide 18, we continue to maintain our discipline in managing crediting rates and net spreads. Trends in the quarterly reported base yields and spreads are impacted by volatility associated with bond accretion and commercial loan prepayment income. Looking forward, and as Sid mentioned, absent significant changes in the overall rate environment, we expect our net spreads will decline by approximately 2 to 4 basis points per quarter.

Turning to Slide 19. Life saw growth in premiums and deposits of 5% from the same period last year on a constant dollar basis. Operating comparisons reflected more favorable mortality experience. U.S. Life sales showed good growth from the same period last year, particularly in term life. Our positive sales trends in Life reflect the evolution of our distribution strategy and further development of independent distribution. We are also making progress in transactions supporting our previously announced plans to reinsure our remaining redundant reserves. We will provide you with updates on these transactions as they are completed.

Turning to Slide 20. I'm happy to report that Personal Insurance reported another strong quarter of operating performance. The operating improvement reflected our strategic actions to reduce expenses, including direct marketing costs as well as early emergence of operating benefits from investments in Japan and other select markets. While we continue to expect that expenses will be the key lever to future margin expansion in Personal Insurance, progress will not be linear quarter-to-quarter due to the nature of our ongoing investments, including in Japan. With respect to Japan, we remain focused on delivering current results, while preparing for the successful execution of the legal merger as previously reported.

To close, I'm pleased with the progress we are making against our strategic priorities across all of our Consumer businesses, and we remain focused on continuing to execute on our plan.

Now I would like to turn it back to Liz to open up the Q&A.

Elizabeth A. Werner
Head of Investor Relations and Vice President
Operator, can we open up now for Q&A?

Question and Answer

Operator

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

Kai Pan
Morgan Stanley, Research Division

So my first -- my question is on the 62.4% core loss ratio Commercial lines. I just wonder, how much more will each of the bucket's reinsurers as well as underwriting actions contribute to future reduction in that loss ratio? Can you talk more about how do you deal with these like multi-accounts, which you need to take some actions?

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

Okay, Kai, it's Rob Schimek. So first of all, let me just refer you back to Page 15 of our presentation and let me make a quick observation for you. In total, through the first 6 months of the year, our premium declined by approximately $1.9 billion. And what you can see is that because the left-hand side of this chart, product set 1 and product set 2A, have stayed, they've increased proportionately, but dollar amount-wise, is very close to flat on a first 6 months of 2016 versus first 6 months of 2015 basis. So what you can see is that almost all of our decline in premium volume has come from product set 2B and product set 3, which is the improved and remediate buckets of our business. The weighted average loss ratio of the business that is no longer being written out of product set 2B and product set 3 was approximately 90%. So you're talking about literally having not written business that ran at a loss ratio of 90% last year and now the business we're still writing in product set 2B and product set 3 have a weighted average loss ratio of about 72%. So I give you that to say that we've truly reduced the amount of writing in those lines of business. And what you can see is we did that without significantly disrupting the business we wanted to grow and maintain in product set 1 and product set 2B. I would generally say to you we continue to be focused on remediating and improving that right-hand side of the page. And our real objective would be how much more can we improve that without disrupting the business we want to grow in with the business we want to maintain. The last observation that I'll make for you here is that our primary emphasis is on maintaining our multi-line client relationships. And the percentages that you see here on Page 15 are probably, generally speaking, in line with what you might expect us to continue to work toward for the full year 2016.

Operator

Our next question comes from Tom Gallagher with Evercore ISI.

Thomas George Gallagher
Evercore ISI, Research Division

Another question for Rob. So if I look at the year-over-year improvement on Commercial P&C, looks like you actually had more coming from international instead of North American Commercial. Now I've been thinking that the story of pruning the underperforming casualty plus the impact of reinsurance should be concentrated on the North American side. I'm not sure if I have that right, but that's been my assumption up until now. And if that's so, does that suggest that international is running ahead of plan and North America is more in line? Or can you shed some light on that?

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

Tom, thanks for your question. I would first say that yes, this is a very much a story about business mix. And what you can see is that the business in North America was what -- was our primary target when it came to reinsurance. And so when we did our reinsurance agreements that I described in the first quarter, those reinsurance agreements really focused around North American Casualty business. We continue to see, broadly speaking, our international business as attractive and are continuing to try to grow in most lines, in particular, in our multi-line -- multinational business. With that said, we see opportunities on a kind of selective basis to remediate even faster some of the business that was in product set 3 and the business that was in product set 2 in North America, partly because the market's been just pretty aggressive. And if the market is aggressive and we have an opportunity without disrupting the broader relationships to remediate, to improve faster in North America, we're happy to do it. I think surely Property in the U.S. is a very important part of this story. As I mentioned in my opening comments, Property rates are down in the U.S., in the excess and surplus lines Property business. And so we have, in fact, reduced the amount of writings that we're doing in the E&S property space. And we will continue to be very thoughtful about the Property business we do write. We're focused on our highly engineered lines in middle markets and large limits where we think we have a sustainable competitive advantage and where we think our engineering capabilities can help reduce the likelihood of a loss in the first place for our clients.

Operator

Our next question comes from Jay Gelb with Barclays.

Jay H. Gelb
Barclays PLC, Research Division

The implied decline in Commercial Property Casualty insurance in 2016 is around 15% and I realized introducing new reinsurance arrangements has a pretty big influence on that. Do you envision positive growth in 2017?

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

Jay, thanks for the question. I think the market will dictate a lot for us because we really want to take advantage of where we see opportunities. In some cases, what I can tell you for sure is we do expect for 2017 to show opportunities for growth in lines of business that we've been targeting. So we do expect that we'll continue to see growth in multinational, in our highly engineered Property lines of business, in Financial Lines for us more broadly. But a lot of this will be dictated by where we see opportunity to further shape the portfolio, whether that's in the U.S. or internationally, based off of market conditions. But in general, I think that you should expect that 2017 premiums overall will not significantly grow from the level we closed out at, at the end of 2016.

Operator

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

Jay Adam Cohen
BofA Merrill Lynch, Research Division

You guys talked about the changes in the Florida workers' comp market, obviously addressing that with your reserves. I got to tell you, we haven't heard much, if anything, from other companies and I'm wondering, do you believe you're acting more quickly than others in this regard?

Siddhartha Sankaran
Executive VP & CFO

Thanks, Jay. It's Sid. Yes, in this case, look, we believe we reacted to new information. There were court rulings in the second quarter and they were obviously unexpected, and we do see this as an industry event. So it's an important set of rulings and we responded quickly as we've told you we would around reserving.

Operator

Our next question comes from Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi

Goldman Sachs Group Inc., Research Division

Just for Rob, just thinking about the shift here, I mean, clearly shifting away from Casualty on a net basis towards Property. How should we be thinking about cat load and severe losses from here? I mean, you mentioned some reinsurance in international Commercial, but it looked like severe losses were a little bit lighter in the U.S. in the second quarter and really first half of the year. So just wanted to get an understanding of whether or not you've taken any actions on the reinsurance side as far as Property is concerned.

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

So Mike, thanks for the question. I have -- I can't resist to take a quick moment to say -- to put a plug in for our Casualty team. We've got the best Casualty team in this business and we will absolutely pursue opportunities to write Casualty business where we think we can get the proper pricing and where we think we can deliver value for our clients. With respect to Property, let me make 3 key observations for you. The first thing I want to say is that over the past few years, you'll see that we've been very actively managing our P&L to make sure that we manage the amount of exposure that we have to catastrophes. We've done that by reducing some of our risk, for example, in the Gulf Coast here in the United States and being willing to take exposures around the world where we think that along the efficient frontier, there's probably better opportunity between the risk reward tradeoff for pricing and risk. The second thing that I would observe for you is that we've really done a lot of work to build our engineering capabilities in Property, as you know. And the growth that you see in Property is coming very much through our middle market and our large-limit highly engineered Property space where we really think we have a competitive advantage and where we think we have the ability to change our loss ratio in a positive way. And the third point that I would make is that, absolutely, we believe that reinsurance provides an opportunity for us here. As I mentioned in my comments, we did take advantage in the second quarter of the opportunity to use reinsurance in a strategic manner to reduce the level of volatility associated with severe losses coming from the Property book. We entered into that agreement at the end of the second quarter, so we think that we'll see much more the benefit from that moving forward in the rest of 2016 and into 2017.

Operator

Our next question comes from Ryan Tunis with Credit Suisse.

Ryan James Tunis
Crédit Suisse AG, Research Division

Another one for Rob. I guess, just looking at the components of the reduction in GOE, it looks like one driver has been loss adjustment expense. And I guess, coincidentally, that's also been a pretty good tailwind for the improvement in the accident year loss ratio in Commercial. I'm just trying to get a feel for, I guess, how much of the 4 to 6 points of the 4 this year and 6 next year in accident year loss ratio improvement was supposed to come from that versus kind of the way I think we had been thinking about it, which was mix shift to risk selection and reinsurance?

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

Ryan, thanks for your question. The first thing I would say to you is I know that you should walk away understanding this, that about 0.3 points of the improvement in our adjusted accident year loss ratio comes from loss adjustment expenses. When you look at Page 9 of the financial supplement and you're trying to make sure that you can sort of reconcile that thought, just remember that any of the GOE that we put in the loss adjustment expenses is effectively deferred and amortized in like a DAC type of concept. And so therefore, you need to be thinking about what is the effect in the adjusted loss ratio on an amortized basis. And so 0.3 points is the right answer for you.

Operator

Our next question comes from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Rob, back to you again. I was wondering, could you give us a sense of what the year-over-year benefit to the underlying loss ratios were in Commercial from reinsurance, seeded reinsurance, and also the combined ratio?

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

Let's see. Let me give you this as maybe a way to observe this for you. One, just remember that if our, I said this in my opening comments, if our total premium decline was 20% in the quarter after foreign exchange, about half of that came from reinsurance and our exits and market headwinds. So you could dissect that piece a little bit further and let me help you. I commented already that rates -- so the market headwinds from rates was about 1%. I commented that, that would then leave you with 9% of the decline associated with reinsurance and exits. If you thought about the exits, about $500 million worth of business is what we've exited, which is pretty small. It's about 2.5% of the $20 billion of premium that we wrote last year. So you might think of the benefit from exits as being something like, let's call it, 2 to 3 points. And so if you said, hey, he explains 10% through reinsurance exits and market headwinds, I think it's pretty fair to say that you probably got about 6 points of your reduction in premium coming from reinsurance. And so that's the effect that it had on the reinsurance. And then, if you want to know what effect it had on the loss ratio, just remember most of that happened in product set 2B and product set 3, but product set 2B, so you can see the loss ratio on the dispersion chart that we show on Page 15.

Operator

Our next question comes from Meyer Shields with KBW.

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

Following the quarter's rate increases in Casualty and Specialty, can you talk about where your rates sort of compare to overall market rates?

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

I think our rates are consistent with market rates.

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

Were they market rates before these increases?

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

We compete in a highly competitive market every day. I would tell you that when we lose business, more often than not, we're losing business to a competitor who quoted a lower rate.

Operator

Our next question comes from Josh Stirling with Sanford Bernstein.

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

So Peter, I was hoping to have just a bit of a strategic question for you. So earlier in the sort of this journey, there was a lot of debate and concern as to whether perhaps AIG was sort too big to succeed. Your modularity approach seemed like a logical way of pivoting the conversation and making it a more manageable series of businesses. I'm wondering if you can talk about, now that you've got 6 months on, sort of in the real world of like your guys' day jobs, what that has actually translated into, systems, people, staffing, new ways of underwriting. And then walk us through a little bit how you think that informs of how we should think about that and forming the future, how far a modularity goes and perhaps just a bit of an update on your sort of broader sort of divestiture strategy.

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

So I think that as the last 20 minutes has illustrated, the focus on the sub-segmentation of the Commercial business, as illustrated in the dispersion chart, is just one example of modularity in action. That chart has 80 individual dots. Each of those dots is a module. And our ability to grow some and shrink others is indicative of what we're doing throughout the organization as we segment our business by product, by geography, by customer segment, by distribution channel and make differentiated managerial decisions to allocate capital where we're being properly rewarded, where we have long-term competitive advantage and pulling back and even exiting where we don't. And the information technology to be able to do that in ever more precise ways and the ability to not be overly swayed by the past but have better predictive analytics about the future, about lost trends and customer demand is what we're talking about. We clearly recognize the need to illustrate that through more transparency and I hope you find what we're doing to show modularity and action within the Commercial book helpful in anticipating where else would applying the same managerial discipline. And we -- as we have promised in January, we'll be talking about modular results at the sort of high level of 9 subsegments of AIG by the end of this year with full capital allocation and ROEs of those segments. But that is really still at the very high altitude compared to what is our day jobs, to use your language, we're doing to make AIG and reshape it into our clients' most valued insurer, which is to focus it where we have the greatest relevance to our target client segments.

Operator

Our next question comes from Elyse Greenspan with Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

If we go back on to Slide 15 and kind of the product sets that you've laid out, I was just wondering if you can kind of talk through and there was any kind of favorable or unfavorable impacts within any of the product sets that might impact sequential loss ratios as we think about the balance of 2016?

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

Well, Elyse, I guess, the best way for me to think about that is what you're really seeing here on Page 15 is simply change in mix. I want to highlight for you that we've only just begun to earn in what is this change of mix that you're seeing on Page 15. So the future impact is that this net written premium earns in much more in Q3 and in Q4, so this mix of business you should feel coming through the loss ratio as we go through the year in even greater way. As it relates to loss picks, et cetera, I can only tell you that every quarter, we review the loss picks with the actuaries. And for sure, we had increased the loss picks in places where we believe that the market headwinds indicate that the loss experience has been greater than we initially expected at the beginning of the year.

Operator

Our next question comes from Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

I just had a question on expenses, just on the sustainability of the expense ratio. You mentioned the ratio could increase because of lower premiums. I'm wondering if you expect expenses to continue to decline over the next 1.5 years. And then related to that, just wondering what your ultimate expectation is for restructuring cost. I think expected restructuring costs have been going up and your most recent Q is $1 billion. At the end of the previous quarter, it was $900 million. At the end of the year, it was $700 million.

So what's your expectation of how much the restructuring cost that you're passing below the line will end up being ultimately?

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

Jimmy, it's Rob Schimek. I'm going to just answer the first part of that and let Sid have the second half. As that relates again to the expense ratio, just go back to what I said in my opening comments. In my opening comments, I made it clear expenses have come down and we expect them to continue to come down in the remainder of 2016 and into 2017, consistent with the actions that Peter outlined and what our strategic actions were that were described in January. With that said, the lower level of earned premiums earns in over the course of the remainder of 2016 and 2017. And because of that, you'll see a slight upward movement in the expense ratio. But again, the most important point, we would expect to reduce our loss ratio by 4 points this year and we do not expect to give that up in the combined ratio by having an offsetting increase in the expense ratio. We expect to be able to hold our ground on the expense ratio.

Siddhartha Sankaran
Executive VP & CFO

Jimmy, it's Sid. On the second question, we obviously don't project out or forecast future restructuring costs. But you should expect as we take management actions, you could see additional restructuring costs and you'll see that updated each quarter in our disclosure.

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

Yes. I just want to make another point about expense control and how we're looking at it. A lot of people, when they talk about expenses, quickly jump to ratios or certain subsegments of expenses like the corporate section or whatever. We feel that the only way to make sure that we have sustainable expense discipline is to look holistically at the entire fixed cost base of the company regardless of how it's classified in LAE or in corporate or whatever and keep that number coming down in a sustainable way. And that will then feed all of the ratios that we care about over time, but importantly ROE and give us a sustainable ROE above our cost of capital.

Operator

Our next question comes from Amit Kumar with Macquarie.

Amit Kumar
Macquarie Research

Just very quickly going back to the discussion on Commercial AOI ex CAT LR of 62.4%. Now that was a roughly 400 basis point improvement over 2015. Your prior goal was 400 basis points by Q4 '16 and 600 by Q4 '17. Do you think it would be fair that there could be a possibility that you could hit your targets sooner than anticipated if you continue on this trajectory?

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

Amit, as I mentioned in my opening comments, there is volatility in the results associated, in particular, with unexpected losses we can get at any time in Property or any of our other shorter-tail lines. We stand by our initial expectation that we've communicated with no change.

Operator

Our next question comes from Larry Greenberg with Janney.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

I'm not sure if this is for Sid or Kevin, but I think you guys do your actuarial review for Life in the third quarter. And I just am wondering if you can give us any visibility on that and how sensitive your profit assumptions are to investment returns and the sensitivity of those embedded returns to the alternative portfolio. So just wondering if there's any thoughts on that.

Siddhartha Sankaran
Executive VP & CFO

Larry, it's Sid here. Yes, we do, do our actuarial assumption review in the third quarter. It's too early to tell. The one area which we've highlighted for you is in the legacy structured settlements where we've done some historical gains harvesting. But the work is still not complete, so we look to the third quarter call where we'll update you a little bit further on that.

Operator

Our next question comes from Adam Klauber with William Blair.

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

As far as share buyback, capital return, you're definitely reducing P&C but particularly Property, which is capital intensive. And then I think you mentioned that you're looking at ways to reinsure redundant Life reserves. Longer term, does that open the door for greater-than-expected share buyback or greater than forecast share buyback?

Siddhartha Sankaran
Executive VP & CFO

It's Sid. Why don't I try and tackle some of the items you mentioned a little more holistically, if it's helpful there. We regularly review our forecast and we remain confident in our commitments on capital return. As I look at where we are today in a little more color on the funding walk that we've previously shared with you, first, legacy asset monetizations have been ahead of where we initially projected, so we feel positive about that. And then, secondly, I think going forward, I would expect us to exceed the $5 billion to $7 billion funding target from dispositions, given where we are today at this particular point in time. That said, given how close we monitor this, there are always some period-to-period changes in our funding projections. So on dividends and tax-sharing payments, we remain roughly in line with our projections and they'll have some variability with market conditions and statutory capital. Our leverage remains in line so it remains a very healthy under 20%. Hedge fund redemptions are on schedule, and there, the proceeds are market dependent, of course. And then, finally, with respect to both Life reinsurance and UGC, on UGC, there's an S-1 out of there so I'm limited on what I can say. I believe we're on track towards our separation. And on Life reinsurance, we continue to make progress and will comment further once we have something that we believe is disclosable. So the punchline to that is, still on track, and we're looking forward greatly to updating you further next quarter.

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

As we get to the top of the hour, I'd just like to end with some closing comments. I'm very pleased with this quarter and very proud of the hard work of all the employees that have made such a great job of the improvements that we have evidenced in this quarter and shown progress in achieving our longer-term goals. But I want to remind everybody, both our employees, our shareholders, our customers, that we're very much on a journey here. We're in the second quarter of an 8-quarter journey to return the company to a level of profitability, which we feel is compelling. And we want to do so while investing in talent and technology so that we -- for the long term, so that we remain relevant to our clients as the world around us changes rapidly. And so this is a measured progress. I'm pleased with the results. I'm pleased with the progress. But we are -- we're still a long way to go and I think we're going to stay very, very focused on execution. And I'm just thrilled at the hard work of our employees, all of them, for the focus on executing this very important plan. Thank you very much, everybody.

Operator
This concludes today's conference. Thank you for your participation. You may now disconnect.