American International Group, Inc. NYSE:AIG

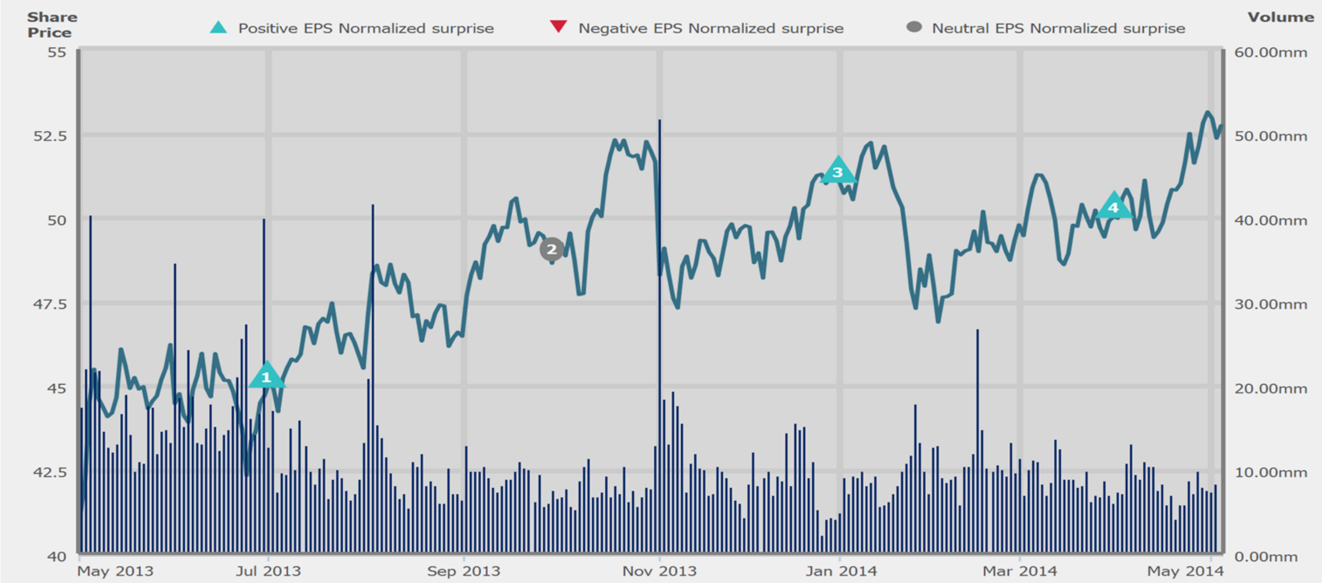
FQ2 2014 Earnings Call Transcripts

Tuesday, August 05, 2014 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2014-			-FQ3 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.05	1.25	19.05	1.06	4.50	5.02
Revenue (mm)	8563.88	8531.00	(0.38 %)	8599.50	34097.50	35884.44

Currency: USD
Consensus as of Aug-05-2014 12:06 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2013	0.86	1.12	1 30.23 %
FQ3 2013	0.96	0.96	2 0.00 %
FQ4 2013	0.97	1.15	3 18.56 %
FQ1 2014	1.06	1.21	4 14.15 %

Call Participants

EXECUTIVES

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Former Chief Strategy Officer, Head of Corporate Mktg & Communications and Executive VP

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Legacy Chief Executive Officer

David Lawrence Herzog
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Elizabeth A. Werner
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Jay Steven Wintrob
Former EVP of Life & Retirement, CEO of AIG Life & Retirement and President of AIG Life & Retirement

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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 Ms. Liz Werner, Head of Investor Relations. Please go ahead.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, Katie. Before we get started this morning, I'd like to remind you that today's presentation may contain certain 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 2013 Form 10-K under Management's Discussion and Analysis of Financial Condition and Results of Operations and also under Risk Factors.

AIG is not under any obligation and expressly disclaims any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

Today's presentation may contain non-GAAP financial measures. The reconciliation of such measures to the most comparable GAAP figures is included in our financial supplement, which is available on our website, www.aig.com.

At this time, I'd like to turn it over to our CEO, Bob Benmosche, and we'll have the opportunity to hear from each one of our businesses and follow up with a Q&A. Thank you.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Thanks, Liz, and I appreciate being with all of you. This will be my last call, and it's been a 5-year period of a lot of excitement. And this quarter reflects a lot of hard work on behalf of all of the people of AIG.

As I know you all know, we started off with a daunting task of stabilizing this company, then paying back America, and we've done that with a profit. And since the re-IPO of the company in 2011, what we shared with all of you is we have to rebuild the foundation of this company and do it the right way and build a great company and expect that our stock will follow and not lead what's happening with AIG.

And so you can see the solid performance in this quarter. We've talked about making sure we execute our capital plan, and it starts off with selling noncore assets, which we've achieved with ILFC in an outstanding sale with -- to AerCap.

We've also been able to repurchase and continue to repurchase our shares. But we said to you also that in addition to dividends and share buybacks, it's very critical that we focus on our coverage ratio. So you've seen us take advantage of the debt markets and reduce our debt with the high coupons and, in some cases, reissue debt, giving us a net benefit because of the lower cost of adding on that new debt. Because we don't have a leverage ratio problem, it's a coverage ratio problem that we're working to fix with the rating agencies, to make sure that we maintain and, quite frankly, I expect to improve, our credit ratings.

You see strong results across all of our businesses. Property Casualty has been working really hard to get it right in terms of its risk selection and making sure that we get value over volume. And that takes a long time. The written business, we don't see the results of it until it's earned, and we see what the loss ratios are. But you can see that improving, along with a high degree of confidence in the reserve, which we've been saying for several years now that you'll see very small movements, plus and minus, in the reserve as we go forward.

UGC was a business that we were going to sell for practically nothing. You can see strong earnings come out of that business, but what's important is rising tides, all boats rise. The fact is UGC was way out in front of that and has a risk selection model that is quite different than the industry. And being part of AIG gives us a lot of flexibility, especially as you look at their ability to manage their capital needs as it goes forward.

And Life and Retirement continues its excellent run as we are becoming a stronger and stronger competitor in that space.

But as you know, succession is very critical to a company and make sure that the company gets it right. We have spent a lot of time thinking about the lead candidates here within AIG. The good news is we did have a strong bench, and I am pleased that Peter has taken over as CEO of this company.

He comes with a wealth of experience both on the Street and the fixed income markets, in particular, which is where most of our net interest income comes from, and has spent the last 3 years really getting into the nuts and bolts of the Property Casualty business from a risk respective -- risk selection perspective, using big data in a way that helps us analyze to make sure that we're putting on the right risk because of the long-tail nature of those risks.

So he's done an outstanding job, and I know that he will do an outstanding job in the future. So what I'd like to do now is officially pass the baton to Peter who will pick up the rest of this call and take you through that.

And again, it's been an honor to serve as part of AIG and all the people of AIG and to be proud -- I am very proud to be part of that team with all of them.

Thank you very much. Peter, I turn it over to you.

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

Bob, thank you, and I'd like to thank Bob for the remarkable leadership he's shown over the last 5 years. And I've experienced 4.5 of those years, and it's truly the most extraordinary 4.5 years of my professional career.

So I think that the employees, shareholders and the U.S. taxpayer owe Bob Benmosche an enormous thanks for the contribution he's made. And his leadership is awesome to follow, but I shall do my very best to continue the legacy of leadership at this company. So I'm really honored to have been selected by the Board of Directors to lead the company going forward.

There's 3 points I'd make. One is that there will be no abrupt change in strategy. This is clearly a vote for continuity. We're on the right track. We're in execution mode. Second, I remain very committed to focusing on value versus simply bulking up the volume of the company. And third, I will not be replacing myself with a Head of Property Casualty sector.

So beyond that, there will be obviously some changes over time. And I'll commit myself to remain very transparent with our shareholders as we fine-tune and refine our strategy going forward. But I think that this is ultimately a choice for continuing to execute the strategy that we have a great deal of alignment around in the company.

So over to you, David, to go over the quarter.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Thank you, Peter, and good morning, everyone. First, I'd like to extend my thanks to Bob for his leadership, his courage and direction. It has been an honor for me, as well as my colleagues, to serve with you, Bob. So many, many thanks.

Now this morning, I'll go over our financial results, including the impact of capital management and our solid operating earnings performance. I'll also highlight our outlook for continued sources of capital management going forward.

Turning to Slide 4. You can see after-tax operating income for the quarter was $1.8 billion or $1.25 per diluted share. Our operating return on equity was 7.7%. Since our earnings are tax-affected and we are not paying tax to the U.S. government, giving -- given our NOLs, our operating ROE, if you were to exclude the DTA from average equity, was about 160 basis points higher or about 9.3%.

Reported net income was $3.1 billion, including a $1.4 billion nonoperating after-tax gain on the sale of ILFC and a little over $325 million after-tax litigation provision for legacy matters. And we also had some other nonoperating items.

Second quarter book value per share, excluding AOCI, benefited from the net impact of all of these items and was $67.65 or an increase of 10% from a year ago.

Our growth in operating income, which is shown on Slide 5, reflects improved insurance operating earnings for each of our core businesses. Collectively, the DIB and Global Capital Markets or GCM delivered another solid quarter with over $500 million of operating earnings, reflecting the mark-to-market appreciation in the DIB and the unwinding of certain derivative positions in Global Capital Markets.

We continue to proactively and opportunistically reduce the DIB's footprint. In the second quarter, we executed on the make-whole call for the March 2015 maturities of $750 million. And subsequent to the quarter end, we redeemed a total of $2 billion worth of DIB debt comprised of nearly $800 million of 2016 notes and $1.25 billion of 2017 notes. We used cash at the DIB and GCM that was set aside for that purpose.

At the end of the second quarter, we had about $8.1 billion of net asset value between the DIB and Global Capital Markets. We expect that the actions that we will take will result in the release of that capital to parent over time as the maturities and liabilities and the underlying assets and derivative positions are monetized and settled.

Also, in July, Global Capital Markets took a significant step in unwinding its remaining super senior credit default swap portfolio by terminating swaps with a net notional of about $9 billion, thereby reducing the notional amount of that portfolio from about $15 billion to around $6 billion.

Pursuant to the closing of the sale of ILFC to AerCap, we now record our 46% equity interest in AerCap's earnings. The $53 million reflects an estimate of the partial quarter of ownership, as well as ongoing basis differences between our pickup and the reported AerCap results. We will have differences from time to time in our estimates and the actual results because of timing. Such differences will be trued up in subsequent quarters.

Corporate expenses were just over $280 million in the quarter, above our expectation of $225 million to $250 million quarterly run rate for 2014 as we recorded an increase of about $50 million related to short-term incentive compensation for the entire firm. We would not expect this to reoccur in the next quarter.

Our reported operating effective tax rate for the quarter was roughly 33%, slightly above our previous outlook of 31% to 32% operating tax rate for 2014. The growth in the earnings from foreign jurisdictions where earnings are not permanently reinvested and the treatment of the AerCap earnings pickup contributed to the higher tax rate. Our expectation is for an all-in operating tax rate of somewhere between 33% and 34% for the remainder of the year.

Our strong capital position as of the end of the quarter is shown on Slide 6. In May, we received $2.4 billion in net cash proceeds upon closing of the ILFC sale. And following the updating of our internal stress testing process, our Board of Directors authorized the repurchase of an additional $2 billion of common stock.

During the quarter, we deployed $1.1 billion towards the repurchase of approximately 18.1 million shares of common stock, and we currently have about $1.5 billion remaining on our share repurchase authorization.

Following the end of the quarter, an additional 1.7 million shares were delivered to us with the full completion of the ASR, which was initiated in June. We also distributed $179 million in dividends to our shareholders in June.

With respect to debt capital management, we have actively managed our cost of debt and our debt maturities. Following the quarter end, we purchased in tender offers about $2.5 billion worth of high coupon, hybrid debt and senior debt securities at the parent company.

In unrelated transactions, we also issued $2.5 billion of debt comprised of $1 billion of 2.3% 5-year notes and $1.5 billion of 4.5% 30-year notes. We continue to be opportunistic in our debt capital management and expect that an improving earnings profile, particularly from our core insurance businesses, will positively impact our coverage ratios going forward.

From this strong capital position, you can see on Slide 7, we received cash dividends and loan repayments from our insurance subsidiaries of $1.6 billion during the quarter. And that was made up of about $700 million from Property Casualty and almost $900 million from Life and Retirement. This brings year-to-date cash distributions to $3.2 billion. We continue to expect $5 billion to $6 billion in cash distributions from our insurance subsidiaries this year.

In addition to these distributions, we received tax sharing payments, primarily from insurance businesses, of about $500 million in the second quarter or almost $800 million year-to-date. Tax sharing payments are expected to amount to about $1 billion in 2014 and roughly $2 billion in '15. Our current expectation is that our tax attribute DTA would be fully utilized by 2020 or '21.

Over time, we will look to our monetization of our deferred tax assets, a portion of our after-tax operating earnings, as well as monetization of noncore assets for capital management purposes. At year end, the DTA was approximately $17 billion. Our current DIB, GCM net asset value is a little over $8 billion, and our 46% equity stake in AerCap shares had a carrying value of about $4.6 billion as of June 30.

Looking ahead to the third quarter, we will recognize a nonoperating gain related to the previously announced $650 million settlement with Bank of America. We also expect that this settlement will provide an additional benefit by allowing us to utilize substantially all of our capital loss carry-forwards. We do not expect this settlement or other litigation-related items to meaningfully impact our expectations for ongoing capital management activity.

With that, I'd like to turn the call back over to Peter.

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

Thank you, David. Property Casualty second quarter results continued to demonstrate our focus on underwriting discipline and risk selection. While we have said that no 1 quarter marks a trend, we're pleased to report that Property Casualty reported second quarter operating income of $1.4 billion, our second highest quarter of pretax operating income in over 3 years. Our focus remains on balancing growth, risk and profitability right across AIG.

Turning to Slide 8. AIG Property Casualty net premiums written increased slightly from a year ago, excluding the effects of foreign exchange, as growth in our consumer lines was offset by lower production in commercial.

Property Casualty's accident year loss ratio as adjusted was 62.7, an improvement of 0.5% sequentially or 0.8 points higher than a year ago. We continue to expect the accident year loss ratio to decline for the remainder of the year but at a slower pace than we've seen in the last couple of years. This quarter included positive net prior year development of $14 million. Our practice of quarterly reserve reviews continues to give us confidence in our current reserve levels.

Our expense ratio declined 0.4 points from a year ago as lower acquisition costs were offset by an increase in general operating expenses. The general operating expense increase reflects our Japan integration costs, some of which have been deferred from the first quarter into the second quarter. Our expectation is that a little less than half of the $250 million of expected integration costs will be incurred this year, with the balance to be incurred in 2015.

Through the first 6 months of the year, we have completed about half of the actions associated with the fourth quarter 2013 severance charge of $265 million. We expect annualized savings to exceed the amount of the severance charge and to emerge later in 2015. We continue to expect expenses to remain relatively flat this year compared to last year and to decline in the second half of 2015.

Turning to Slide 9. Commercial Insurance net premiums written declined slightly from the same period in the prior year, primarily from our decision to walk away from certain risks. We saw growth in our global financial lines business, as well as in specialty lines. However, we continue to see a competitive market in certain casualty lines and in U.S. property CAT as a result of overcapacity in the market.

Commercial Insurance rates overall were unchanged in the quarter and up 1% in the U.S. from a year ago. While overall rate trends are a metric that we and others disclose, we believe it is the granularity and agility of our pricing strategy that has the greatest impact on our margins.

The broad product cycles of the past have evolved to a much greater pricing dispersion across industries, geographies, exposure layers and individual accounts. Our focus on pricing each risk appropriately leads to our confidence in accident year loss ratio trends and continued risk-adjusted profit growth.

The accident year loss ratio, as adjusted, in Commercial increased to 66.4 from 62.2 in the quarter a year ago as a result of higher severe losses. We indicated last quarter that severe losses could be volatile, and that was the case again this quarter. We view some volatility in severe losses as consistent with our diversified global property portfolio. Most importantly, our global property business continues to deliver positive risk-adjusted profitability.

Turning to Slide 10. Net premiums written for Consumer Insurance increased 4%, excluding the effects of foreign exchange. This growth was driven by sales of Life & Health products in Japan, as well as growth in our personal property business in Japan and the United States. In Consumer, we continue to focus on improved underwriting quality and targeted growth in key markets where we can achieve meaningful scale.

The Consumer accident year loss ratio, as adjusted, improved 4.5 points from a year ago to 55.7, reflecting rate increases and improved loss experience in Japan auto, and rate actions and coverage changes in the U.S. warranty business.

The Japan auto accident year loss ratio, as adjusted, did benefit from seasonality. Therefore, we expect to see this ratio rise somewhat in the third quarter. For the full year, we expect Consumer to show improvement in its accident year loss ratio, as adjusted, compared to last year.

Slide 11 provides our investment returns and portfolio composition. Our asset allocation strategy is intended to optimize portfolio diversification to maintain stable portfolio risk while enhancing yield. Our alternative investment returns for the quarter slightly outperformed our 8% return expectation but were down compared to the strong year-ago quarter.

With respect to capital management, we remitted $701 million in cash dividends to the holding company during the quarter. We also made tax sharing payments of $276 million in the quarter and are on track to meet our expectations for contributing additional capital to the parent.

Turning to Slide 12. Mortgage Guaranty's operating performance continues to improve, with operating income for the quarter of $210 million. Operating income for the quarter benefited from $89 million of favorable prior year reserve development. The delinquency ratio of 4.8% for the quarter continued to fall as the volume of new delinquencies declined and cure rates improved. Our current delinquency count is the lowest it has been since late 2007.

Mortgage Guaranty continues to benefit from its broad customer base, leading market position and improving housing market. As the highest-rated U.S. mortgage insurer, United Guaranty is well positioned to compete as the industry evolves.

In closing, AIG Property Casualty continues to advance on its strategic initiatives, work collaboratively across AIG businesses and further build value for all our stakeholders.

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

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

Thank you, Peter, and good morning to everyone. Beginning on Slide 13. The second quarter of 2014 was another strong quarter for AIG Life and Retirement. We extended our record of consistent performance, generating nearly $1.2 billion of operating earnings and delivering both top line and bottom line growth.

Our operating income benefited from strong growth in fee income as separate account balances increased for the seventh consecutive quarter. Net flows were over $6.3 billion during the last 12 months, further increasing the scale and reflecting the product and distribution diversification of our businesses.

Life and Retirement generated nearly $2.6 billion in net investment income in the quarter, with a slight decline from the prior year period, primarily attributable to lower returns on alternative investments. We maintained the cost of funds at historic lows in our Fixed Annuity and Group Retirement businesses through disciplined pricing of new business and renewal crediting rates and a runoff of older business crediting relatively high interest rates. These trends helped to partially offset the pressure on base investment yields in the current low-rate environment.

Now in addition to strong earnings, Life and Retirement delivered $886 million of cash dividends and loan repayments, as well as $642 million of noncash dividends to AIG Parent in the second quarter. The Life and Retirement businesses have distributed nearly $6 billion of cash and noncash dividend to AIG Parent over the past 12 months.

The segment ended the quarter with shareholders' equity, x AOCI, of $34.5 billion, $1.3 billion higher than a year ago.

Sales were strong during the quarter, reaching nearly $7.4 billion in premiums and deposits, an increase of 9% over the year-ago period. Growth was driven by our Retail segment, which delivered a 15% increase in premiums and deposits from the year-ago period. Retirement Income Solutions, which includes our individual variable annuities and fixed index annuities, achieved another record quarter of sales, generating nearly $2.6 billion of premiums and deposits.

The increase in the quarter was principally driven by index annuity sales, which were $305 million in the quarter, up from $55 million in the prior year period. Variable annuities sales were up 4% or $90 million in the quarter over the same time period last year. Both lines benefited from product enhancements, expanded distribution and continued strong demand for guaranteed lifetime income benefits.

Fixed Annuities sales reached nearly $1.1 billion in the quarter, tripling from the year-ago period. Sales remained steady despite the low interest rate environment as Fixed Annuities continued to be very competitive relative to bank CDs and money market alternatives.

We continue to serve our distribution partners and enhance our franchise through successful new product introductions that offer consumers the retirement security and protection they are seeking and need. We've designed product features with income options that consumers value, while also ensuring that we achieve our target IRRs and maintain an attractive risk profile.

All of these factors have led to strong sales momentum. It should be noted that rising interest rates and strong equity market conditions in the second half of 2013 [ph] resulted in record sales levels and growth rates in the second half of 2013 [ph]. Without similar market conditions in the second half of this year, we would expect lower sales growth rates in key product lines versus the prior year.

Assets under management in Life and Retirement increased by more than $39 billion or 13% over the last 12 months to reach $333 billion. Growth in AUM was driven by an increase of nearly $14 billion in separate account assets, attributable to strong sales and account balance appreciation.

General account assets increased by nearly $6.5 billion as a result of unrealized gains in the fixed income portfolio and positive net flows into the general account. Our stable value wrap business grew significantly over the last 12 months, increasing by over $12 billion in AUM. We plan to continue to develop this business although at a slower pace of growth. The diversified mix of our assets under management reflects the balance of our business, and we're pleased with the growth we are achieving across our product suite.

Slide 14 provides our line of business comparisons. Both Retail and Institutional pretax operating income increased from the year-ago period. Growth in the underlying business was somewhat muted by the strong net investment income results we experienced a year ago, specifically attributable to outsized returns in alternative investments and the strong performance in certain commercial mortgage loans and structured securities.

The Retail segment benefited from strong sales and net flows in variable annuities. Together with favorable equity markets, this resulted in higher variable annuity account values and fee income growth. Disciplined pricing, crediting rate management and the runoff of older business with relatively high crediting rates helped to offset some of the impact of declining base investment yields on spreads in the Fixed Annuities business and the fixed account component of the Group Retirement business.

The Institutional segment benefited from higher fee income in Group Retirement, which was largely driven by growth in assets under management from equity market appreciation. Surrender rates in both our Retail and Institutional businesses declined year-over-year as the persistency of our business improved in the quarter.

Consumer demand for Retirement Income Solutions remains very strong. As mentioned in previous quarters, over the past 4 years, we've redesigned our products to reduce risk to AIG. 75% of our $27.6 billion of variable annuities with guaranteed minimum withdrawal benefits include strong derisking features, such as the VIX indexing of our rider fees and volatility control funds. In addition, we require minimum allocations to the fixed account, which also reduces risk.

Nearly half of our index annuities sales in the second quarter included guaranteed lifetime income riders. In designing these features, we applied the same product development and risk management expertise we built into our variable annuity business.

Slide 15 shows our trends in yields and spreads. The base yield in the quarter was 5.17%, down from 5.35% in the prior-year quarter and 5.32% in the first quarter. This decline in part reflects a difficult comparison to prior quarters due to the strong performance in commercial mortgage loans and structured securities in the comparative prior periods.

Additionally, new money reinvestment rates remain lower than the weighted average yield of the existing portfolio as a result of the sustained historically low interest rate environment. Should rates remain at current levels, you would expect a 2 to 3 basis point quarterly decline in the base yield.

We continue to actively manage crediting rates on our in-force block and remain disciplined in our new business pricing, as demonstrated by the decline in cost of funds for both our Fixed Annuities and Group Retirement businesses year-over-year.

Further, at the end of the second quarter, 71% of our Fixed Annuity and universal life account values were at minimum guaranteed crediting rates. This is down from 73% at year end, thus providing us with further opportunity to reduce our cost of funds in the future should the low interest rate environment persist.

Slide 16 shows our investment portfolio composition, which remained stable and continues to be highly rated. Total net investment income does fluctuate from period-to-period, as can be seen in the alternatives line and other enhancements, which reflect the mark-to-market nature of certain investments.

The decline in net investment income from a year ago is primarily a result, again, of alternative investment returns coming in close to our expected 10% annualized return this quarter compared to the exceptionally strong returns experienced a year ago.

So to sum it up, it was another strong quarter for earnings and distributions to AIG. We continue to execute on our strategic initiatives, which include growing our distribution organization, increasing the productivity of our wholesalers, affiliated agents and financial advisers.

We're also successfully leveraging our strong relationships with distribution partners to increase penetration of our broad retail product portfolio, build on our market-leading positions and offer competitive and profitable retirement income solutions.

We continue to pursue growth opportunities in our Institutional businesses where we can achieve the most attractive risk-adjusted returns, while the continued low interest rate and tight credit spread environment leads us to maintain strong pricing discipline.

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

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

Question and Answer

Operator

[Operator Instructions] We'll take our first question from Tom Gallagher with Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Peter, first question I had is just a follow-up on your comment that you will expect the accident year loss ratio to decline at a slower pace in the back half of '14. Does that change your overall P&C combined ratio goal that you've put out there or your 10% ROE goal overall? Or does that push it out a bit? That's my first question.

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

Well, I think [indiscernible] just pushes it out a bit. I think that we're clearly experiencing some headwinds in the pricing of U.S. property CAT, which is an element of our Commercial business. But there's softness in a couple of other sectors as well. So the pace at which we get to our ultimate profitability goals is a function of market conditions. But certainly, our ambition is to get there. And at this point, to speculate on the exact pace is to speculate on the market cycle. As I mentioned in my remarks, we are diversifying our book of business, so we're less subject to the cycle and are focusing on subsegmentation at a more and more granular level so that we have greater confidence in these trends in a more sustained way.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay, and then just a related question. If you strip out the noise, it doesn't appear that accident year casualty results in Commercial improved very much this quarter. First question, is that right? And secondly, what's going on behind that?

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

I think that the casualty area has gone through the greatest change. So an enormous reunderwriting of the book over the last 4 or 5 years, a quite considerable change in our claims practices. And so the emergence of loss trends has a fair amount of noise in it. So our actuaries are being quite cautious in recognizing improvements. And we are always on the lookout for any emerging threats. So I think that we feel confident that the casualty business has moved from a significantly RAP-negative line of business to now earning into our cost of capital. But we still see room for improvement and growth in this sector as we apply more refined underwriting tools and better claims practices. But, John, do you want to elaborate on that, anything further?

John Q. Doyle
Former Chief Executive Officer of Global Commercial Insurance

No, I think that's right. And, Tom, there wasn't real improvement in the casualty loss ratio in the quarter, that's right. But the accident year loss ratio pressure was really in the quarter driven by short-tail losses, not just severe but on the attritional side as well. Some of it in the U.S. weather-related losses, some of it in nonproperty short-tail lines as well. But to Peter's point, we've done a lot of hard work on the casualty side, and we do expect a bit of improvement in the loss ratio performance in that business going forward.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got it. And then just one for David on capital management. The first, $960 million legal settlement that occurred in July, did -- was that accrued for in 2Q results? Or is there some loss forthcoming in 3Q related to that?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

That had been previously accrued.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got it. And then is it fair to assume the $2.5 billion refi of the higher coupon hybrids in debt, we should take that as a sign that you really don't need to reduce leverage on a go-forward basis in terms of financial debt? I take that to mean that because that obviously improves your coverage ratio. And if that's the case, can we then further assume that pretty much most, if not all, dividends and tax-sharing payments would be available for share repurchase after you've paid interest in corporate expenses?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Well, first of all, we don't give guidance, Tom, on the specific composition of our capital management. It's opportunistic, and it's taking advantage of market conditions, our view of the environment and our balanced approach to both equity and debt. So I wouldn't -- I'd be careful making any sort of broad-based assumptions about what we will or won't do with respect to the mix of debt capital management and equity capital management. They're both important. We obviously remain committed to capital management and lowering of the cost of our overall cost of capital. And we'll do so. I think you can look to, as I said in my remarks, a portion of our after-tax operating earnings, the DTA monetization and the monetization of noncore assets to fuel that capital management going forward. So we will continue to be active in both debt capital management and equity capital management for the foreseeable future, that's a critical value driver for us, and we'll continue to do that.

Operator

We'll take our next question from Josh Stirling with Sanford Bernstein.

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

So first, let me say, Peter, congratulations on your new role. And, Bob, I think we'd all like to say thank you on behalf of AIG's investors. Really was very dark days, and with your leadership and all the firm's hard work, it's been really dramatic recovery. So we all wish you the best in your well-deserved retirement.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Thank you.

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

Thank you.

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

If I could, 2 questions. So, Peter, the pricing environment has changed a lot in the past couple of quarters. Pricing is now flat, and you're seeing pricing actually fall relatively notably in property lines. How can we get comfortable with this? You're saying that you're going to manage the value over volume. You said perhaps property's still at positive RAP, and you're going to maintain against your pricing targets. But it's a little -- it's hard to see from outside what your pricing targets are or what RAP is by line of business, what RAP you're targeting, for example. And ultimately, I'd love it if you could just sort of walk us through how you're thinking about your current rate adequacy by line of business, maybe on your RAP measure or on

-- and even simpler, what are the target combined ratios you guys are actually trying to get to? And where on the business you're writing today do you think you still actually have rate gain [ph]?

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

Well, I think first of all, let's put the pricing environment in perspective. The pricing environment 3.5 years ago when I started the job was massively inadequate in the United States but reasonably adequate in Europe and the rest of the world. There's been tremendous upward movement in pricing, steadily quarter-after-quarter, since that point. And so we've had a good improvement in the pricing environment across lines -- all lines of business in the U.S. And the pace of that increase has slowed but has reversed itself narrowly in U.S. property CAT. And that's really where the greatest impact of alternative capital and the reinsurance soft market has had an impact. We have been diversifying away from U.S. property CAT for about 5 years and diversifying our property portfolio around the world. So we've diminished our exposure to that particular cyclical phenomenon. I think that the use of RAP today equips our underwriters and our account relationship managers with much better tools to make a well-balanced judgment over how to manage the portfolio of multiline relationships with customers to take a balanced view of short- and medium-term profitability across lines. And so while we may not want to renew at the same scale as previously, we certainly want to be relevant to our customers and offer capacity, maybe at a different attachment point where we feel we're getting a better value for the risks that we're taking. So I just think we're much better equipped to deal with the inevitable cyclicality in the pricing environment, and we have a tremendous diversity of business by geography and line so that we can redeploy the capital to where it's best rewarded in a customer-friendly way that maintains valuable relationships. But I don't know whether, John, you want to elaborate on that.

John Q. Doyle
Former Chief Executive Officer of Global Commercial Insurance

Yes. I think, Josh, what I would add is that it's not a market, right? There are many markets around the world. And outside of the property CAT market in the United States, the rate environment was quite stable. In the U.S., in fact, where, as you know, we have our biggest exposure, all of our other major lines of business saw rate increases in the second quarter. So longer-tail lines. We saw good discipline in the quarter, albeit not at the same rate of increase as we saw earlier in the year and last year. But we were disciplined in the quarter about the property CAT business in the U.S. We walked from more than $200 million worth of property CAT business in the U.S. As Peter mentioned, from time to time, we've moved up on programs where we had important customer relationships or saw attractive opportunities at different parts or different layers in a program. But -- and Peter mentioned the diversification. We saw good middle-market property growth. We saw good growth in property outside of the United States. We've had a large limits initiative underway, highly engineered portfolio growth initiative over the course of the last several years. That all performed reasonably well in the quarter. So it's -- again, it's kind of not one market, and it's not just about price either. We've invested a lot in risk selection, managing our mix of business, important claim improvements and more granular pricing strategy. So obviously, price matters ultimately, but there are other techniques that are important levers for us as well.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I -- and I just would add that the one AIG that we talk about, when you think about our global footprint and how we are coming across to our multinational clients, we bring the full AIG to each country where up until a couple of years ago, each country was on its own. So part of what you see here is the transformation of the company to a more global company, not because we're in many geographies, because we operate as one AIG to our clients around the globe. And that's helped us a little bit here as well.

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

If I ask just a -- I'll just ask one follow-up on that. If pricing is being a bit more of a headwind, how would you walk us -- can you walk us through the other initiatives you'd use to try to achieve the low-90s combined ratio? And is that still a realistic prospect given that the environmental tailwinds have fundamentally shifted?

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

Well, I think that if the softer segments are so pervasive that the pricing adequate segments don't make up for the lost volume, clearly, fixed costs become a major focus if we're going to avoid negative operating leverage. So that's going to be an important thing to focus on. It's something that we started focusing on long before this change in the pricing environment because we always believed that managing down our fixed costs was essential to not feeling tempted to price the marginal deal to maintain volume. So I think that continued focus on sustainable expense improvement, use of shared services, use of automation, modernizing our infrastructure, gives us the flexibility to back off on volume when it's not properly priced and then scale it up again when it is. So I think that managing the cycle is dependent on continuing to work on our core infrastructure.

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

Great. Let me ask you a quick technical question. Charlie and John, you guys -- just trying to parse what you said about reserves and the fact that Commercial accident year loss ratios, especially with -- backing out severe losses, have been basically stable for the past year, should we be interpreting that you're sort of basically -- you're basically holding your accident year loss ratio picks flat? That's the reason we're not seeing improvement, and that you're just intending to let the favorable development in Commercial sort of eventually sort of power through the -- and sort of demonstrate -- bring you guys to your low 90s combined?

John Q. Doyle
Former Chief Executive Officer of Global Commercial Insurance

Josh, I would say that it's a mix of up and down in loss picks. But as shorter-tail losses move more towards normal levels, as I said, we have had elevated levels of short-tail losses through the first 6 months and the second half last year. And we're comparing against a better-than-expected first half of last year. I would add, as we move to more normal levels, the longer-tail loss picks are slightly ahead of where they were a year ago.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Come on, Charlie. Charlie...

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

Yes, Charlie. Charlie, do you want to chime in on this?

Charles S. Shamieh
Legacy Chief Executive Officer

I think John said it well. I mean, every quarter, we do look at our parent accident year loss picks against loss cost trend and rate change. And as John said, there are adjustments in each direction. And I consider where we've set them to be absolutely our best estimate at this stage.

Operator

We'll take our next question from Jay Cohen with Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I guess this one is for David. You talked about the amount of capital that still resides at the DIB and the Global Capital Markets business. But it's beginning to run off quicker. When should we expect some of that capital to begin to get freed up?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, thanks, Jay. And I'll lead off and maybe Brian, in the team back in New York, can add on. We've said over the course of the period of -- up until about 2018 that about 80% or so of the liabilities will mature in the normal course if we do nothing. We've obviously been more proactive and opportunistic in calling some of those. I think the dynamic that is -- that will impact the amount of capital that gets freed up is actually as the underlying assets monetize because we're paying off the debt essentially with cash that we had accumulated. And so there's not a great deal of capital charge and capital tied up in the term debt and the cash that's sitting there. So again, it'll -- we still would expect a very significant portion of the capital free up over that period of time. Maybe, Brian, if you want to add a little more color.

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

No, David, I think you hit the key points. As we've said in the past, some capital will be freed up between now and '18, but the bulk of the capital will come out post-'18. The way we run the DIB is through something we call the ACE test that ensures we have adequate net asset value and adequate liquidity to meet both contingencies and obligations as they come due. And as David said, as assets monetize, as the ML III assets pull to intrinsic value, that capital will get freed up. And in some way, it's also more of a function of our ability to proactively go after the liabilities or having to wait until they actually mature.

Operator

We'll take our next question from Mike Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

So a couple of quick ones and then maybe a broader question. On the consumer business in the U.S., the combined dip below 90, just wanted to get an understanding of sort of what happened there and how much of that was the repriced warranty business. And is that sustainable for you?

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

Kevin, why don't you take that?

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

Okay. Yes, thanks, Mike. Yes, the warranty is an important part of the improvement. As you I think are aware, we had an elevated loss ratio in certain products last year, and we took quick underwriting action, which took hold. But in addition to what we did on the warranty, we've also been consistently filing some rate improvements in the PCG property portfolio, which is starting to earn in.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. Okay, great. And then same question on the MI. It looks like the underlying, if we back out the development, was just below 60. How should we be thinking about that business?

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

Sorry, the mortgage insurance?

Michael Steven Nannizzi

Goldman Sachs Group Inc., Research Division

Yes, the MI. It looks like x development ran at a sub-60 combined. Is that -- is there anything in that quote like underlying that we should think about? Or is that kind of where you expect you'll be running that business?

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

It's a business which will have a very attractive combined as long as the housing market stays as firm as it is and as long as employment trends stay as firm as they are. And so we think about it with a CAT load that's over and above that steady-state combined ratio against the cyclicality. But it's a very attractive return on risk business at this point in the cycle. And as you can see from the delinquency trends, very, very attractive. About 2/3 of the business -- or the reserves are on business post-crisis. So it's a cleaner and cleaner reserve book at this point.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And then just last question. Just talking about reserves there a bit, I mean, when we think about -- we talk a lot about the combined ratio of the P&C company. I mean, obviously, the mix of business is changing from what you wrote historically. How should we think about capital -- the capital you're going to need on a run rate basis to sort of run that business as the reserves for some of the longer-tailed lines run off, some of which you're not really writing anymore? Is there -- is that something that we should be sort of thinking about as you -- especially if you potentially stop growing or grow less quickly than -- in some of these capital-intensive lines?

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

Yes. I think that we have explicit runoff portions of the casualty lines, which we show in corporate and other, that consume a certain amount of capital, and that runs off. And then there are certain subsegments, which are still in the commercial line segment, where we are deemphasizing and shrinking certain long-tail lines, which are capital-intensive. But that capital frees up gradually as those -- the tails of those businesses start to play out. So I'd say so 4- to 10-year sort of time horizon for that capital to be freed up. But it's quite substantial, and we're redeploying that freed-up capital gradually into shorter-tail lines where we're getting a better return on risk. And so I think that we are somewhat opportunistic in terms of where we deploy that capital, and we have a lot of different choices because of the breadth of our franchise.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

And Mike, I would say in the commercial portfolio, at the end of 2010, property was about 16% of our net written premium and is now close to 25%. At the same time, our specialty classes and financial lines grew a bit as a share of the total, too, largely coming at the expense of U.S. Casualty over that period of time.

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

And I should add that with that increase in property, there has been no increase in our PML because we've been diversifying away from the U.S. Property CAT exposures.

Operator

We'll take our next question from Jay Gelb with Barclays.

Jay H. Gelb
Barclays PLC, Research Division

Peter, 2 questions for you. One, you initially mentioned that you saw -- you would see no abrupt changes in strategy and were focused on continuity. Does that mean you anticipate any changes in strategy?

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

I anticipate changes in strategy as the opportunities arise but nothing that I would want to signal at the moment because I think that Bob and I have been highly aligned on strategy for the last 4.5 years. So unless something in the external environment changes abruptly, in which case, we might have to consider abrupt changes. So the team as a whole has really coalesced around our current strategy and is in execution mode. So I think that's really the signal. This is a great confidence in the team, a great confidence in the momentum that we've built, and changes in strategy will be largely refinements in the execution.

Jay H. Gelb
Barclays PLC, Research Division

The other question I want to ask is for you to maintain the Head of the Property Casualty business, do you view that as a temporary situation or perhaps permanent? Given the size of AIG, it feels like that's a pretty big load for one person to carry running more than -- or essentially being Chief Executive Officer plus being responsible for the largest single unit of the company. And related to that, have you received commitment from other leadership of AIG to remain at the company?

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

So on the Property Casualty, increasingly, John and Kevin, running the Consumer and Commercial segments, have assumed a broader strategic leadership that those 2 very large segments deserve. And we are very focused on making the whole company more -- flatter in the hierarchy. And so we want to minimize the layers of management between the CEO and the trenches to improve our responsiveness to customers and markets. And so it's, in my view, redundant to think about the Property Casualty layer going forward. The leadership that John has on the Commercial and Kevin has on the Consumer provides absolutely the right amount of strategic leadership that's needed. So I don't see any challenges there. And as far as the commitment of the senior leadership of the company, I think we've all been through a lot together over the last 5 years. There were plenty of reasons for anybody to throw the towel in over the last 5 years. I'm very hopeful that everybody who went through the challenges over the last 5 years looks forward to the next 5 years with as much enthusiasm as I do.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Katie, I think we're going to -- we're at the top of the hour. So I'm afraid we're going to have to get back to everybody who's dialed in. And we certainly appreciate everybody's interest and look forward to speaking with all of you this afternoon.

Operator
That concludes today's conference. We appreciate your participation.