S&P Capital IQ

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American International Group, Inc. NYSE:AIG

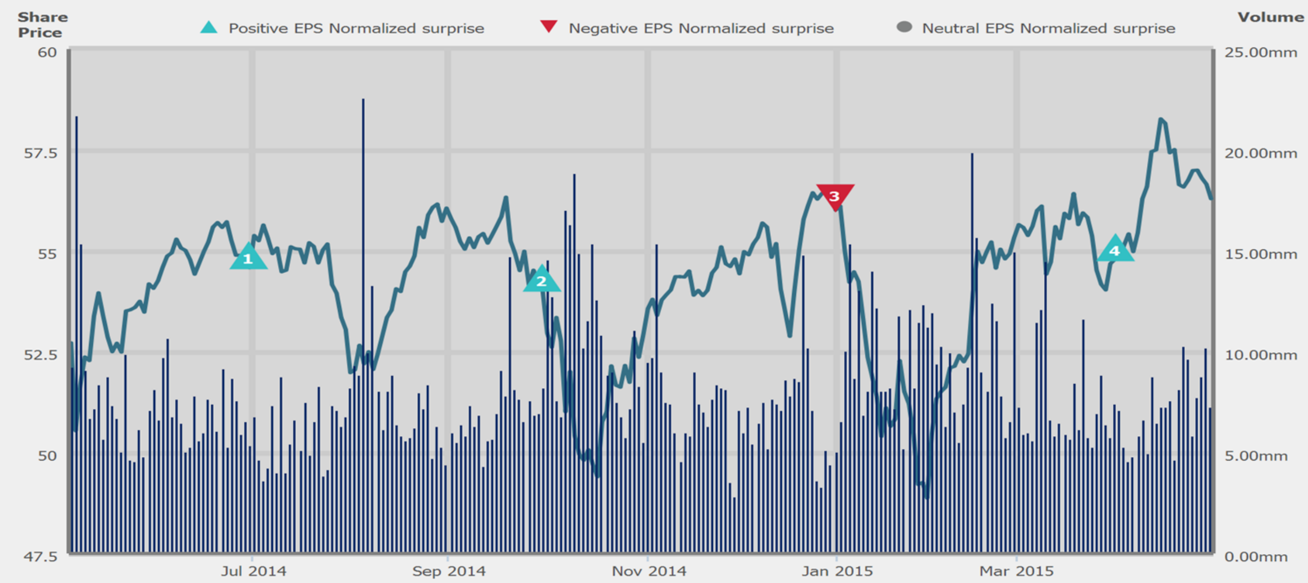
FQ2 2015 Earnings Call Transcripts

Tuesday, August 04, 2015 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2015-			-FQ3 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.22	1.39	▲13.93	1.19	5.02	5.58
Revenue (mm)	14559.55	15699.00	▲7.83	-	60643.00	46735.50

Currency: USD
Consensus as of Aug-04-2015 12:33 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2014	1.05	1.25	▲1 19.05 %
FQ3 2014	1.09	1.21	▲2 11.01 %
FQ4 2014	1.05	0.97	▼3 (7.62 %)
FQ1 2015	1.19	1.22	▲4 2.52 %

Call Participants

EXECUTIVES

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Elizabeth A. Werner
Head of Investor Relations and Vice President

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

Kevin T. Hogan
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Presentation

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

[Audio Gap]

quarter increase in interest rates and credit spreads. Net adverse prior year development, net of reinsurance premium and premium adjustments of $279 million was due largely to our commercial auto book. Within Consumer, less favorable mortality results in life and lower net investment income and personal insurance drove the comparison.

Reported net income in the second quarter was $1.8 billion, and included net after-tax realized capital gains of $79 million, which included an after-tax realized capital gain associated with the sale of a portion of our holdings in Springleaf of just over $230 million and an after-tax realized capital loss of just over $350 million associated with the sale of a portion of our AerCap shares, including the write-down to fair value of our remaining stake.

We continue to hold about 10.7 million shares or about 5.4% of AerCap's outstanding shares. We also incurred a little over $200 million in after-tax loss on extinguishment of debt as we continue to pursue economically attractive debt repurchases.

Slide 5 provides details on the Corporate and Other operations. As I mentioned last quarter, given the substantial progress in the wind-down of the Direct Investment book and Global Capital Markets, or DIB/GCM, we are no longer reporting DIB/GCM as a separate component of Corporate and Other. Earnings generated by the assets and derivative positions of the former DIB/GCM are being reported in a line called income from other assets.

In addition to the returns from these assets, this line includes earnings associated with the legacy real estate investments, the legacy life settlement portfolio and the parent company liquidity portfolio.

Income from other assets was just over $500 million in the second quarter. Earnings from our investment in AerCap through the date of the sale were $127 million. Our 5.4% stake in AerCap is being accounted for under the available-for-sale method and thus, no equity method earnings will be recognized going forward. PICC generated about $170 million in pretax operating income in the quarter. This mark-to-market will be volatile from period-to-period, as we have seen since June 30.

Our reported operating tax rate was just over 34%, in line with, but at the high end of our expectations.

Turning to our financial objectives on Slide 6. Book value per share, ex AOCI and DTA, continues to grow at a strong rate with a 7% increase year-to-date and a 10% increase year-over-year, reflecting net earnings and the accretive share repurchases.

With respect to ROE, we estimate a normalized ROE for purposes of measuring our progress against an internal baseline of 7.4%. On this basis, ROE year-to-date is roughly flat to that baseline. The normalization adjustments for workers' compensation discount, prior year development, better-than-expected investment returns and lower-than-expected CAT losses, among other things, together lowered our reported operating ROE by roughly 260 basis points for the quarter and 150 basis points for the year. Our reported operating ROE, excluding AOCI and DTA, was 9.3% for the quarter and 8.8% year-to-date.

General operating expenses, which are summarized on Slide 7, were $2.9 billion in the second quarter and $5.7 billion year-to-date, down 3% -- 3.6% for the quarter and 3.5% year-to-date from the same period a year ago.

The favorable effects of a strengthening U.S. dollar benefited the year-over-year comparisons, but were offset by other noteworthy items in the quarter, increasing expenses from completed acquisitions were not offset by any divestitures. Also higher pension costs associated with the current low interest rate environment negatively impacted year-over-year comparisons and should have less of an impact as rates rise. Further, I would emphasize that the trends can vary from quarter-to-quarter. That being said, we remain focused and committed to the operational and cost efficiency, and we are on track to achieve our 3% to 5% objective through consolidation initiatives, such as our work in Japan, utilization of scaled service centers in lower-cost locations and other cost-optimization initiatives.

On Slide 8, you can see our current capital structure. During the quarter, we deployed over $2.3 billion towards the purchase of approximately 40 million shares. We also purchased an additional $965 million worth of shares in July. Our current unused authorization stands at roughly $6.3 billion.

We also continue to manage the cost and maturity profile of our debt. In April, we repurchased in cash tender offers $1.3 billion aggregate purchase price and in July, we repurchased in cash and tender offers an additional $3.7 billion in aggregate purchase price. Also, in July, we issued a total of $2.5 billion of 10-year, 20-year and 30-year notes. We also issued $290 million of 30-year callable notes. The average interest rate on our financial debt, including the hybrids, is now below 5%.

We continue to be opportunistic in our debt capital management, which is focused on the cost and the maturity profile of our debt. We currently do not expect any meaningful change in our debt-to-total capital ratios from their current levels.

Cash flow to the holding company remained strong, as you can see on Slide 9. Holding company -- the holding company received total distributions from our insurance subsidiaries of about $2.1 billion during the quarter, including over $700 million of tax sharing payments. We expect insurance company dividends and distributions of somewhere between $3 billion and $4 billion for the balance of the year.

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

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

Thank you, David, and good morning, everyone. Today, I would like to discuss second quarter results, market trends and our outlook for the remainder of 2015.

Pretax operating income for the Commercial segment was $1.5 billion compared to $1.6 billion in the prior year quarter due to mix results across the segment. Commercial Property Casualty pretax operating income declined largely due to CAT losses that were higher than the unusually low quarter a year ago, but still below expectations. Mortgage Guaranty delivered another strong performance and Institutional Markets completed a large terminal funding annuity in the quarter.

Turning to Slide 11. Commercial Property Casualty had modest top line premium growth in the quarter, excluding the effects of foreign exchange. Specialty and Financial Lines recorded strong premium growth, which was largely offset by declines in casualty and property. Casualty and, in particular, U.S. Casualty, was impacted by our continuing strategy to optimize the portfolio, while competitive market pressures affected U.S. Property E&S lines.

We continue to see strong growth in our large limit and middle-market property business globally, which is less catastrophe exposed than the E&S book. It is also where we are making significant investments in engineering and client risk services.

Financial Lines grew in all regions, particularly in strategic areas, such as M&A and cyber risk. Specialty had strong growth in programs, marine and trade credit line and included $30 million in revenue growth from the acquisition of NSM.

Market conditions in aerospace continue to be challenging, and we are taking appropriate underwriting actions in that industry segment.

Rates across Commercial Property Casualty declined slightly in the quarter, excluding U.S. Property, which was down 5.3%. There are significant rate pressure in the excess and surplus property business in the U.S., where our rates decreased by 7.8% during the quarter.

Specialty and Financial Lines recorded moderate -- excuse me, modest rate increases globally. Our diversification by product and region somewhat mitigates the impact of competitive market trends. But given our efforts to optimize the portfolio and to walk away from inadequately priced business, we expect net premiums to be roughly flat for the second half of the year, excluding FX.

The accident year loss ratio was 66.6% in the quarter, a slight increase from the prior year reflecting higher severe losses in specialty and increased loss picks [ph] in segments of U.S. Casualty, partially offset by improved loss experience in property.

For the quarter and year-to-date, severe losses are running slightly above expectations. We believe the second half accident year loss ratio will improve by approximately 1 to 2 points, meaning that the full year results will be close to the low end of our initial 1- to 2-point full year outlook. We remain confident in the actions we are taking to improve underwriting profitability.

In the second quarter, we increased Commercial auto liability reserves by $285 million after frequency and severity trends exceeded expectations following the economic recovery. We have also taken appropriate underwriting actions in the segment as a result of those trends.

General operating expenses continue to improve, decreasing 3% compared to the same period last year, excluding the benefit from foreign exchange. Our organizational efficiency initiatives continue to come through even as we invest in IT, shared services and client risk services.

Net investment income increased 6% and included $54 million of PICC appreciation and strong alternative investment returns. This more than offset lower interest and dividend income, which was driven by the low interest rate environment and our small -- smaller investment portfolio, reflecting continued paydown of loss reserves. We expect trends related to low interest rate environment and the relative size of the investment portfolio to continue for the remainder of the year.

Turning to Slide 12. Mortgage Guaranty pretax operating income was $157 million versus $210 million a year ago. The year ago results benefited from $89 million of favorable prior year development versus $17 million this year.

Operating earnings grew 16% year-over-year, excluding the effect of prior year development. Results reflect record-breaking new insurance written, favorably impacted by a drop in mortgage rates, which is driving refinance and purchase volumes and improvements in existing home sales due to lower down payment requirements.

Additionally, delinquency rates continue to show an improving trend. In a rising interest rate environment, we would expect new production to slow, although the outlook for the remainder of the year is better than we expected at the start of 2015.

During July, the Mortgage Insurance business also completed an innovative MI cap bond issuance, which transferred about $300 million of 2009 through 2013 risk at the capital markets.

Turning to Page 13. Institutional Markets pretax operating income decreased to $151 million from $170 million in the prior year quarter, primarily driven by lower call and tender income, partially offset by higher investment yields on alternatives backing reserves and surplus.

During the second quarter, institutional markets completed a large terminal funding annuity transaction for $527 million in premium and covering about 2,700 participants. We participate in this market on a case-by-case basis, subject to our ability to achieve appropriate returns.

While performance in the quarter overall was mixed, we continue to make good progress on our long-term strategies to improve the profitability and sustainability of the portfolio, while differentiating our offering to our clients.

Thank you. And now 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, John, and good morning, everyone. This morning, I'll discuss the trends in our Consumer Insurance business, provide an update on our ongoing investments in Japan and comment on the Department of Labor's proposed fiduciary rule.

In the second quarter, our Consumer Insurance businesses generated pretax operating income of just over $1 billion. Our performance this quarter benefited from strong alternative investment income and continued fee income growth, which was offset by lower base portfolio income, less favorable mortality experience and lower investment income and underwriting income in personal insurance. Base portfolio income decreased as a result of lower reinvestment rates and lower invested assets, principally driven by significant dividends to AIG Parent over the last 12 months.

Turning to Slide 15. Operating income for retirement was $804 million for the quarter and benefited from strong alternative investment income performance and higher fees due to growth in separate account assets.

On Slide 16, you can see that base yields for Group Retirement benefited in the quarter from additional accretion income. We expect base yields to decline 2 to 4 basis points quarterly for the remainder of the year, given higher interest rates.

The impact to net investment spreads was partially mitigated by adhering to disciplined new business pricing and active management of crediting rates. The outflow of older policies, which carry higher crediting rates than current rates offered also contributed to the reduction in our cost of funds, which has declined for both Fixed Annuities and Group Retirement over the last 4 quarters.

Assets under management ended the quarter at $225 billion, 1% lower than a year ago, reflecting lower unrealized gains due to higher interest rates and the aforementioned substantial distributions to AIG Parent over the last 12 months. Assets under management also reflected strong net flows from Retirement Income Solutions and positive separate account investment performance that was partially offset by net outflows for Fixed Annuities and Group Retirement.

Net flows for Fixed Annuities continued to be affected by low interest rates, and we will continue to maintain pricing discipline in this environment.

The level of surrenders in our Group Retirement business declined, both sequentially and compared to a year ago. We expect group surrenders to occur periodically as planned consolidations continue, although we are seeing a lower level than prior year.

In Retirement Income Solutions, although recent market results suggest pressure on new sales of variable annuities, our index annuity sales continued to gain momentum and macro trends support the growing customer need for quality income solutions.

Now let me turn to the department of Labor's fiduciary rule proposal that I commented on briefly last quarter. At AIG, we shared the DOL's goal of ensuring that financial advisers work in their clients' best interests, and we endeavor to put that goal into practice everyday. However, we believe that the proposal as is may lead to unintended consequences for consumers that are inconsistent with the DOL stated goals. We expressed these concerns in a comment letter we submitted to DOL on July 21. In this letter, we focused on the policy considerations that we believe the DOL should consider to ensure that consumers have all the knowledge and tools necessary to actively plan, save for and ultimately, enjoy their retirement.

We were encouraged by the recent news that the DOL plans to make modifications to the proposal, and we will continue to monitor this closely and work with the DOL and our industry peers to help achieve an outcome that benefits the American consumer.

In terms of likely business impact, we participate broadly in the retirement value chain through the advisory space, Group Retirement, Fixed Annuities, index annuities and variable annuities. If the rule as promulgated work to be implemented, each part of the business may be impacted differently with likely the greatest impact on the advisory business and least impact on the fixed and index annuity business.

Because of our broad participation in the value chain, we are confident that we have the resources and expertise to respond as needed in any future environment and to continue to meet the growing needs of consumers for guaranteed lifetime income and other savings solutions.

Slide 17 presents results for our global life business. Life pretax operating income of $149 million declined, primarily due to reduced contribution from mortality gains from the year ago quarter, which more than offset strong alternative investment income performance. Mortality remains within our pricing assumptions, although less favorable compared to the same period last year.

General operating expenses increased from the same period last year due to the expansion of our life business in Japan and the U.K. and strategic investment in technology and distribution platforms.

The acquisitions of Ageas Protect Limited, now AIG Life Limited, and Laya Healthcare, have added about $25 million to quarterly run rate general operating expenses for life.

Life premiums and deposits grew 6% from the year ago period, excluding the effects of foreign exchange, reflecting the continued growth in Japan and the acquisition of AIG Life Limited.

Turning to Slide 18. Personal insurance reported pretax operating income of $70 million, which reflects a decline in net investment income and lower underwriting income from the prior year quarter.

Net premiums written grew 2% from the same quarter a year ago, excluding the effects of foreign exchange, reflecting increased production in the automobile business across all regions and in the property business, primarily in the U.S. and Japan due to new business growth in both Japan and the U.S. and improved client retention in the U.S. This growth was partially offset by decreased production in warranty service programs in the U.S. as new premiums reflect an increased deductible structure we instituted to improve performance in this portfolio.

The personal insurance accident year loss ratio improved 0.6 points from the same quarter a year ago, reflecting lower losses in warranty relative to the increased deductible and in A&H. The lower loss ratio associated with the warranty program was largely offset by an increase in the related profit sharing arrangement contributing to the 1 point increase in acquisition ratio from the prior year.

The general operating expense ratio increased from the same period last year, primarily due to higher employee-related expenses and the timing of technology-related projects.

We continue to invest in our businesses, including in Japan and our other strategic growth countries, such as China and Brazil, which has impacted our reported combined ratios. With respect to the Japan integration, we remain intensely focused on execution of this major program of works. We expect to complete the integration of the 2 companies in the second half of 2016 or later, pending approval from the relevant authorities in Japan. While this integration date is slightly later than our original expectations, it does not impact our view of the attractive returns from this initiative.

In our Private Client Group and Personal Insurance, we remain focused on the high end of the U.S. market, targeting those individuals requiring a broad range of risk management, services, and insurance. For example, we currently insure 40% of the Forbes richest Americans. We have been adding resources, capabilities, and additional product offerings for our clients and brokers to further enhance our position and capitalize on recent market opportunities in this segment. The Private Client Group annualized net premiums written totals about $1.4 billion.

To close, for our Consumer businesses, we remain focused on achieving profitable growth and effectively managing risk by executing on our customer-focused strategies, maintaining a prudent risk profile and targeting capital-efficient growth opportunities.

Now I'd like to turn it back to Liz to open up to Q&A.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Before we begin the Q&A, I'd like to just say, I know that the webcast was a little delayed this morning, and we'll be posting Peter's remarks immediately following the call for anyone who was on the webcast and missed those.
Operator, could we open up the lines for Q&A?

Question and Answer

Operator

[Operator Instructions] It appears our first question comes from Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I just have one question, Kevin, on -- in international consumer, it looks like the expense ratio was 41% or so in the quarter. It was up both year-over-year and versus the quarter. That was in North America, Commercial -- or Consumer. Can you talk a little bit about what happened there and how should we be thinking about that? And was any of the tech spend that you referred in that part of the business?

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

I'm sorry, Mike, can you just -- can you repeat the last part of that question?

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I just -- whether any of the sort of technology spend that you referenced in your remarks were incorporated in that higher expense ratio?

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

Yes. In North America, we are investing in the Private Client Group business, as I mentioned, and that does include introducing some new administrative platforms. But I think the primary source of increase in our expense ratio was really is for the investments that we're making in our growth markets in China and Brazil and also in preparation for the merger in Japan.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay, right. I mean, year-over-year, that North America expense ratio was up from 34% to 41%.

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

Okay. All right. I think you're referring to the acquisition ratio, which is relevant to warranty services program. The increased loss ratio was offset by an impact from a profit sharing arrangement. Profit sharing arrangement shows up in the acquisition ratio.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay. So did that continue? Or is that something that is a 1 quarter phenomenon?

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

It varies a bit quarter-to-quarter depending on the underlying loss ratio performance in the warranty business, which is a little bit volatile. As you go back to 2013, you'll recall there was a spike in the losses there, and that's when we introduced the deductible into the program. So we're continuing to monitor the experience there. I think that the bulk of the earned premium change for the new program will be through in the next 2 quarters.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. Great. And then just one question, Peter, on holdco liquidity. Clearly, you've got $13.5 billion there just over that now, and you've got the repurchase authorization set up in front of you. How should we be thinking about once you kind of move through some of this capital? What's the right number that you should have at the holding company, or do you expect to have a holding company sort of on a run-rate basis?

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

So yes, that's a somewhat dynamic number. It relates to the degree to which we're able to upstream excess capital from the subsidiaries, while maintaining the confidence of local stakeholders that care very much about those stand-alone entity capital ratios and liquidity positions. We -- some portion of that liquidity, the holding company, is effectively contingent capital to support the group-wide risk levels. And as we did in the aftermath of Superstorm Sandy, we promptly injected about $1 billion into the P&C sub. So it's not all surplus for general purposes, it's earmarked for that. So the risk profile is dynamic, depending on the growth of the underlying businesses. But we are very mindful of maintaining positive momentum with the rating agencies. And so the pacing of our capital return is based on our view of relative value of our stock versus any acquisition opportunities and organic growth opportunities. The surplus is there in between those actions. So I think that there's no sort of fixed number that you can plug into a model. It's somewhat dynamic.

Operator

Your next question comes from John Nadel with Piper Jaffray.

John Matthew Nadel
Piper Jaffray Companies, Research Division

I have a couple of questions this morning. The first, I guess, is for John. John, you indicated that you still expect 1 to 2 points of year-over-year improvement in the Commercial line's accident year loss ratio in the back half of the year. If we look at the first half of the year though, it's -- I guess it's slightly down. So I guess it's less clear to me where your confidence is stemming from in that piece [ph], particularly given the pricing dynamics that we're seeing so maybe you can give us some color on that?

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

Sure, John. I've talked about before, pricing is just one element of our underwriting improvement, risk selection, mix of business, and investments and claims are also important levers. And then I mentioned our investment in client risk services, and Peter talked about our vision to be our clients' most valued insurer. We're winning business more today on that value proposition as opposed to in the past. So it's not strictly price. In the second half of the year, I would expect property underwriting -- some of our shorter tail results in both Property and Specialty to return to more normal levels. And as I said at the beginning of the year, there's some volatility obviously with the short-tail lines. And I guess, in addition to that, the Commercial auto, we up -- as I mentioned in my comments, we did up our loss fixed largely around Commercial auto in the second quarter. So there's some catch-up in the second quarter, as we did it from the beginning of the year so. Those are the primary drivers but as I've said in the past, they're going to be some bumps up and down along the way. But we do expect continued improvement in the second half.

John Matthew Nadel
Piper Jaffray Companies, Research Division

Okay. That's helpful. And then maybe a question for David. So DIB and GCM now collapsed into this other line with your life settlements, investments, real estate and other stuff. Can you just -- can you maybe give us a sense for all those things included in that other investments net, what's a reasonable normal level of earnings contribution from all of those varying assets whether on an annual basis, a quarterly basis? Some way to give us a sense because the -- I think we've sort of lost sight of any real clarity there.

David Lawrence Herzog

Former Chief Financial Officer and Executive Vice President

Thanks, John. Sure, I guess, a couple of ways to think about that. The amount of assets that are there, we give you some insight into that on -- in the financial supplement, I think it's Page 11. And it took -- it's in the $30 billion range. We lay all that out, and that's where all the assets in the Corporate and Other column there reside. As you say, we've got the assets and the cash positions of the assets that were dedicated to the DIB/GCM. And that, again, that their --they haven't materially changed since we last reported them. You've got the mark-to-market and you do have some terminations still from time to time. The -- so if you think about the earnings there, there was about $500 million of earnings this period, and then if you add to that the earnings on PICC are included in that $30-odd billion on Page 11 as well as the AerCap shares. That was all in that. So you've got about $800 million for the earnings on $30-odd billion of assets. So that's, again, it's going to -- it will be -- it will move around. It will be variable from period to period. But that's kind of how you ought to think about it, comparing that balance sheet to that -- to those earnings. And again, you'll -- you can get a sense of things like PICC, which is going to have some variability to it.

John Matthew Nadel
Piper Jaffray Companies, Research Division

Okay. And then if I could sneak one more follow-up in. Just thinking about the normalizing adjustments to the ROE, you're removing 100% of the unfavorable prior year development. And I guess you're just doing that in each period just for your comparability purposes. You're not really trying to signal to us, or maybe you are, that prior year development is expected to essentially go away or be a 0 drag or 0 contribution, are you?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Well, I'll start. Peter, if you want to comment as well. But it -- we do normalized 100% of it. Likewise, we normalize 100% of the discount change. And again, we make our best estimates on the reserves. So we don't -- we're not signaling either we expect favorable or unfavorable. We're making our best estimates, and you've seen reserve development on both sides of that.

John Matthew Nadel
Piper Jaffray Companies, Research Division

I guess maybe -- yes, sorry, maybe just a better way of asking the question is, when you think about that 50 basis points or better of ROE improvement, you're not assuming any drag or contribution from prior year?

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

Correct.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

That's correct.

Operator

Our next question comes from Jay Gelb with Barclays.

Jay H. Gelb
Barclays PLC, Research Division

With regard to the rapid consolidation in the Property Casualty sector, can you talk about what you think the implications are for chub and ACE getting together? And whether that means AIG perhaps needs to do a large deal?

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

It's Peter here. No, I don't think that it has any implications for us needing to do a deal. We are already, by many measures, one of the largest insurers in the sector. I think that margin pressure and other issues may be driving others to consolidate. And I think we've got a lot of work to do to digest the acquisition and merger in Japan with Fuji Fire and Marine. We got work to do to divest things that don't fit well within our vision of this company in the future, and we will be making more modest acquisitions to add capabilities. So yes, what it does do is it creates opportunity for us, I think, both in terms of customers, talent, and a slight shift in the balance of power between carriers and brokers, because in the high net worth space in the U.S., for instance, you've gone from 4 carriers to 2 in the space the last 6 months with that consolidation, so -- and the Fireman's deal. So I think there's puts and takes, but I don't see any change in our strategy as a function of this maybe a better market for anything that we sell.

Jay H. Gelb
Barclays PLC, Research Division

On the divestitures comment, Peter, what areas perhaps would AIG look to exit?

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

We haven't specified any particular properties, but we're looking very carefully through our strategic review of where the synergies exist today, whether they could exist in the future and where we feel the -- particularly strong bids for assets that may or may not fit in our future. So we won't declare that until we're ready to sell.

Jay H. Gelb
Barclays PLC, Research Division

I see. And then on the pace of a buyback, clearly, it ramped up dramatically, I think, in part driven by the AerCap divestiture. Should we consider that roughly $2-plus billion a quarter buyback pace as a run rate now?

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

We signaled in the first quarter that we were shifting from what we described as a metro normal-like [ph] buyback pace to a more dynamic buyback strategy, and the reason for that is various. But in particular, as the share price appreciates, we are very value-conscious, and we look at the relative value of buybacks versus alternative uses of capital and certainly, don't want to be buying back stock above intrinsic. So I think it's a number that will be somewhat dynamic as a function of opportunities to grow our core businesses through organic growth, but that's fairly modest but more importantly, market dynamics in terms of share price versus intrinsic.

Jay H. Gelb
Barclays PLC, Research Division

Of course. Put another way that the remaining $6.3 billion authorization, do you think that can be completed, say, by early 2016?

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

I can see situations where it could be completed by the end of this year. And I can see situations where it might extend a bit. So I don't think there's a strong constraints. Obviously, we've got daily limits in terms of the permissible amounts per day. But other than that, I think we've got room to accelerate this well within the 2015 calendar year, but it will be dynamic.

Operator

Our next question comes from Kai Pan with Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

First question, Peter, you mentioned that the 50 basis point ROE improvement this year is adjusted for the AerCap divestiture, which means that you're excluding this out. I just wonder what's the earnings impact from recent divestiture, including AerCap as well as you've -- last quarter, you mentioned about like redistributed about $2 billion release capital from your DIB and GCM?

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

David, why don't you take that?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes. Kai, it's David. On the AerCap, the foregone earnings that we would have expected on a pretax basis were somewhere around $400 million-or-so for the balance of the year. And dependent on the assumptions on the capital redeployment that will drive or will affect the actual ROE adjustment, but it's somewhere in the 30 to 35 basis points on a full year basis. So you can -- that sort of gives you the parameters.

Kai Pan
Morgan Stanley, Research Division

And on the direct events booked?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, sure. I was going to comment that the $2 billion of capital that we released was part of the consideration and part of the capital that we evaluated in amending our capital plans. So it's a been taken into account.

Kai Pan
Morgan Stanley, Research Division

Would that have the impact on the earnings going forward?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

No, not really. It was earning only a modest amount.

Kai Pan
Morgan Stanley, Research Division

Okay, that's great. Then follow-up maybe for John. Could you talk a bit more about the Commercial auto business? And also, is that -- it's not just for -- is this just for this sort of accident year? And also is that related also to your -- the $279 million reserve charges in the Commercial lines?

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

Sure, Kai. There's about $285 million charge to strengthen Commercial auto reserves. We're certainly disappointed in the result. The book had performed pretty well through 2010 and it, in fact, performed very, very well during the height of the recession in 2008 and 2009. We certainly expect it to return to more normal loss trends during the economic recovery and began to see that. But over the course of last couple of years, we saw some data emerging that changed our outlook a bit. We did begin taking some underwriting action more than a year ago and pushed some rate increases through more than a year ago, but both frequency and severity exceeded our expectation. Some of the data we saw a year ago, we thought may have been a bit of an anomaly. But as we did our deeper dive and updated things throughout the course of the last 4 quarters, that turned out not be the case. So we revised those plans and our pricing targets based on the deeper view we just did in the second quarter and are taking action in the market right now.

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

Yes, I would just make a further comment about this, which is while this is a fairly sizable adverse development in recent accident years, the cumulative development in recent accident years is still positive, including this. So I think that's an important sort of contextual fact.

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

We've had about -- close to 200 million of favorable development from 2011 through 2014 accident years.

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

Inclusive of it.

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

Including Commercial auto charge.

Operator

Our next question comes from Tom Gallagher with Credit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

First question for either David or Peter. So if I look at the 50 basis point ROE improvement guide that you're reaffirming, that would imply for next year, and I, granted I heard what you said about AerCap for this year. But for next year, that would still imply about, we'll call it, 5 80 of earnings power, which would be about 45% per share earnings growth over what you had produced this quarter. Now I realized this quarter had some negative items in it, but that's pretty steep earnings growth in a year. Can you comment on conviction level on getting there or at least close to there? And whether or not you need some serious tailwinds to emerge to get there?

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

Well, I think that, for start, the way we think about this year-on-year improvement is to normalize a lot of the noise. So as much as possible of that improvement is within our control. And probably the most important driver that's in our control is expenses. And we have a number of major initiatives to deliver on our expense targets, and we have a high degree of confidence that 2016 will meet or exceed our expense targets. And so we're working hard on that. Yes, there are obviously other dynamics that are less in our control, as John has talked about in terms of shifting profitability dynamics in the Commercial sector, but we have the benefit of an extremely diverse book and a dynamic of allocation of capital and business mix to respond to those changing dynamics. And we also have the possibility of capital deployment and the timing of that in a way that will be accretive.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got you. And Peter, do you -- thinking about the -- your led off with the -- on the expense side, and I know Kevin had mentioned second half '16 or later is when you expect the Japan merger to close. Is that really the biggest lever that you have out there? And will that be, we'll call it, a big sort of cliff-type scenario in the overall expense base of the company? Or is it not likely to be that extreme?

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

It's one of several, to be honest. It's one that has been in the pipeline for such a long time that we have referred to it many times in previous calls. So yes, I think that that's -- it is a substantial amount of money. And it does tail off pretty fast after the merger occurs. So yes, you'll see a cliff improvement after that merger date which, as Kevin indicated, that's the end of 2016, a little bit later than we had originally signaled. But no, there's many other expense initiatives underway that cover all dimensions of the company and, in particular, in holding company and support functions. Shared services have also been underway for some time. And as I've talked about in previous calls, you have sort of a mirroring effect as you migrate jobs to shared service centers where you duplicate the cost base until you've done the migration. And then one thing I want to just emphasize is that while we get these net expense savings, we have not slowed down our project spend. So we actually have a slight increase in project spend this year versus last year. So the gross cut to the expenses are deeper. But we recognize that long-term sustainable expense savings can only come from better use of technology, and that technology can only happen if we spend the money on the projects now. So it's quite a substantial effort going underway in a number of different dimensions.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got you. And just one follow-up for either John or David on -- thinking about property casualty catastrophe budget. Last year, it was $1.5 billion. This year, year-to-date, according to the normalized ROE guide, it's only coming in at around $500 million according to your budget, even though the CAT themselves have been lower than that. Should we assume a similar budget for this year, which would mean about another $1 billion of CAT budget for the balance of this year? Or is there a likely to be a change when you think about planning for catastrophes?

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

It's not a material change year-over-year. I guess what jumps to mind in asking the question is the precision in which you're thinking about kind of modeled CATs during the course of the second half the year, right? To be obviously, very, very meaningful deviation relative to the budgeted result. We had I think about $250 million turn, $60 million in CAT losses in the third quarter last year, less than half of our budgeted AL in the quarter. So -- but yes, you're roughly in the right range.

Operator

Our next question comes from Jay Cohen from academic honor...

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions, most have been answered. The Direct Investment Book, can you give us some sense of how much equity is left in that book?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Jay, it's David. We still have about $5 billion-or-so of capital that is dedicated to or required by that. And so it's still, again, it hasn't materially changed since the $2 billion release.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

And just a quick follow-up on that one. The run-off of the DIB, you seemed to have accelerated over the past year or 2. The pace of that run-off, should we think of that continuing at this pace or should it slow from here?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Well the -- well, a couple of things. One, let's break it up in the -- to the pieces. The termination or the wind-down of the derivative positions is obviously coming to an end. So that what I would call the acceleration of the final leg of that wind-down will slow over time. The monetization of the capital will be, as we've said in the past, largely a function of how the equity tranches in the CDOs that had been tranched internally, how that ultimately winds down. We'll continue to, over time, monetize both the equity tranche of that and then do that internally, but you could expect that that's going to take several years to monetize. Peter, you want to add to that?

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

Yes. I think that while there's some element of this wind-down that is legacy, the ability to do internal securitizations, which is just the split, the senior versus subordinated risk of various asset types, allows us to invest in certain asset classes that are not particularly well treated under statutory capital rules in the insurance companies themselves. So by holding the equity at the holding company, we're able to efficiently participate in parts of the capital markets, which we'd otherwise incur very substantial capital charges within the regulated entities. So there's an element of that holding company capital that will always be reserved for those sorts of operations, so that we can invest with the greatest degree of freedom in the capital markets.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Very good. And then the second question was, given all the changes in your debt structure, can you give us some sense of what the ongoing quarterly interest expense will be given all the changes you've made?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

I think, hang on, let me grab the fin sup, you can see, we've got a page for there, I think it was around $270-odd million this particular quarter, and we had some modest refinancings that were done in July. So you can factor those in. We bought in about $3 billion of higher coupon debt and reissued 10s, 20s and 30s at below that. So the average is now below 5%, the average of our debt. For the senior debt plus the hybrids is below 5%, just below 5%.

Operator

Your next question comes from Josh Stirling with Sanford Bernstein.

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

So Peter, I was hoping to ask you sort of broader question about the market structure and how you think things play out from here. So pricing is falling a lot and -- but people in the sort of smaller phased part of the business, domestically focused guys like, for example, Travelers, talk a lot about the end of the traditional cycle sort of this post-cycle world given data and analytics and more discipline and accountability, and the business broadly has become much more boring as a result. But you guys write much larger accounts, the specialty lines, global risk. And against that, you've -- but -- which historically has meant that there's been a terrible -- terribly, cyclically part of the business, which is -- with the place you play. However, you very actively investing in data and analytics, you've put in place a lot of tools to drive discipline and accountability, and we're also now seeing that you guys as well as some others have a fair amount of market share in this business. And so I'm wondering as you think about sort of the market power you guys have to be leaders as well as your own investments and basically being a smarter and better run firm, is it -- should we be thinking about you of sort of having a soft-market strategy of basically trying to just be a post-cycle firm? Or is this something where we should be looking and saying that's just not really possible in the markets you play, and so we ought to be looking at you and holding you sort of more accountable to sort of more traditional soft-market strategies and judging on that basis?

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

Well, I think, they're very interesting question. I think the opening statement that the -- we have very substantial declines in pricing, it -- perhaps a broader generalization that I would use. I think that you've seen it happen in U.S. Property CAT pricing, and I think that one of the biggest tools we have to manage that particular cycle is the willingness to look at our property book globally and diversify away from the heavy concentration in Gulf wind exposure. So I think that, that helps. I think the data and analytics is very helpful in managing and understanding how to better estimate expected outcomes, but the drivers, the unexpected outcomes need to be also divided between things that are driven by external factors or not, the systematic factors. And so one of the, I think, big trends in the future will be greater use of alternative capital to lay off that risk. So I think that effective use of cheaper alternative capital as a supplement to our own balance sheet can make sure that we dedicate our capital to where we are adding most value, and that's very much an integration of capital markets, pricing techniques, plus predictive modeling and changing underwriting and actuarial methods to really be more forward-looking. And I think that helps deal with the cyclicality in those factors. So if you have a very strong interest in nontraditional players to take on a systematic risk like Florida wind, we can still serve our clients well while tapping into that cheap capital, and that's factored into our thinking. So I think, that, yes, the best response to cyclicality is to be more nimble in our capital usage, both how we allocate our internal capital and how we take advantage of other people's capital and weave it into our offering to our clients. But at the end of the day, that requires a deeper understanding of our risk, segmentation of risk between the parts of the risk that's idiosyncratic versus systematic and your well-trained underwriters who are equipped with good tools, which is a logistical issue where we have to invest in technology, training and so on, so they have the tools to compete in that world. But we're very committed to that future, which we think is going to position us very much to be our clients' most valued insurer.

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

That's helpful, Peter. If I could just ask one more, a quick on sort of a bit more tad closer to the execution. One of the things you guys have been sort of actively doing is pursuing sort of strategic organic growth and now some tactical acts with some acquisitions to expand your footprint. This is coming at a time that you guys still have a fair amount of wood to chop driving margins in your core business. And I'm wondering, as you think about how you manage the leadership team and how you prioritize the sort of the actual efforts of all the folks running around to try to manage the company, how you're balancing the dual objectives you're giving the organization of realizing the margin potential of your core business as well as trying to build a future portfolio, fits the portfolio you want?

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

That's a good -- that's a great question. We recently had the top 200 leaders of the company get together for a few days to debate that exact point. And I think that the way we used -- a framework we used was 3 horizons, really acknowledging that the world around us is changing very, very rapidly and, therefore, we need to have our eyes firmly on the future, so building long-term sustainable value with a 5- to 10-year time horizon. We also need to be deeply grounded in the present to make sure that we continue to deliver on our promises in terms of better operating performance. And then we need to have a credible plan in the middle horizon to bridge from the present to the future. And that we, as individual leaders, need to balance our time between those 3, but also we need to also have individuals sort of specialize in each of those 3 horizons so that we have an adequate attention paid to all 3. And what I came away from those few days with the top 200 was a high degree of alignment in how we will execute that. So I feel that the company is very much aligned around how we need to change and adapt, but keep the right balance between urgent priorities to improve short-term performance without losing sight of our opportunities over the very long term.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you. Operator, I think we've kind of surpassed our time here. So I'd like to follow up with anyone who's in the queue after the call, and thank you all for joining this morning's earnings call.

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