

# American International Group, Inc. NYSE:AIG

## FQ1 2020 Earnings Call Transcripts

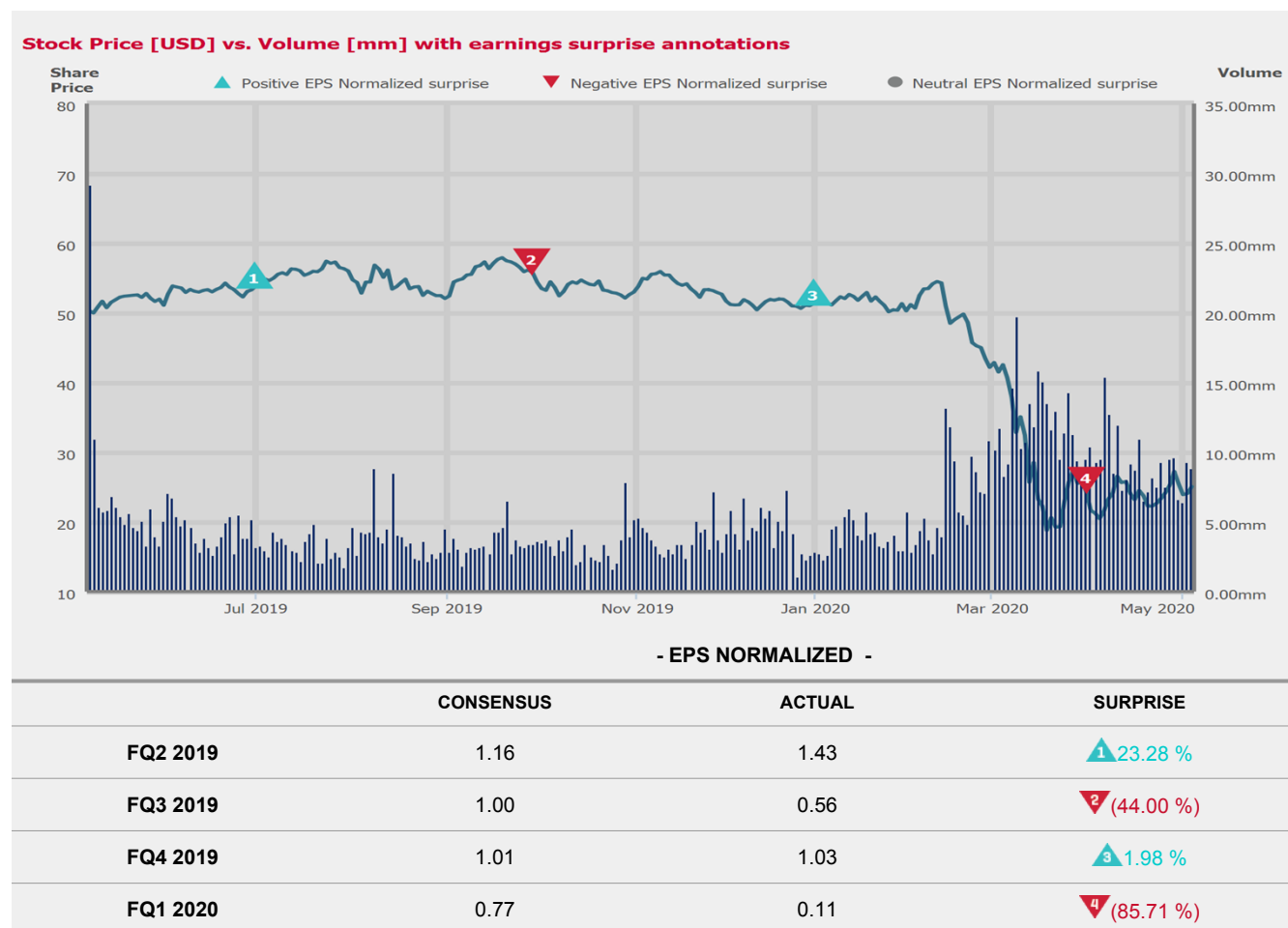
**Tuesday, May 05, 2020 12:00 PM GMT**

S&P Global Market Intelligence Estimates

	-FQ1 2020-			-FQ2 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.77	0.11	▼ (85.71 %)	0.93	3.26	4.73
Revenue (mm)	11527.71	-	▲ 25.29	11674.22	47194.64	47807.04

Currency: USD

Consensus as of May-05-2020 10:40 AM GMT



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# Call Participants

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# Presentation

## Operator

Ladies and gentlemen, good day, and welcome to AIG's First Quarter 2020 Financial Results Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Ms. Sabra Purtill, Head of Investor Relations. Please go ahead, ma'am.

## Sabra Rose Purtill

*Deputy CFO and Head of Treasury, Investor & Rating Agency Relations & Corporate Development*

Thank you. Good morning, and thank you all for joining us today. Our call today will cover AIG's first quarter 2020 financial results announced yesterday afternoon. The news release, financial results presentation and financial supplement were posted on our website at [www.aig.com](http://www.aig.com), and the 10-Q will be filed later today.

Our speakers today are Brian Duperreault, CEO; Peter Zaffino, President and COO of AIG and CEO, General Insurance; Kevin Hogan, CEO, Life and Retirement; and Mark Lyons, Chief Financial Officer. We will have time for Q&A after their remarks.

Today's call may contain forward-looking statements relating to company performance, strategic priorities, business mix and market conditions, including the effects of COVID-19 on AIG. These statements are not guarantees of future performance or events and are based on management's current expectations. Actual performance and events may differ materially. Factors that could cause results to differ include those described in our 2019 annual report on Form 10-K and other recent filings made with the SEC, inclusive of the effects of COVID-19 on AIG, which cannot be fully determined at this time. AIG is not under any obligation and expressly disclaims any obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise.

Additionally, some remarks will refer to non-GAAP financial measures. The reconciliation of such measures to the most comparable GAAP figures is provided in our news release and other financial results materials, all of which are available on our website.

I'll now turn the call over to Brian.

## Brian Charles Duperreault

*CEO & Director*

Good morning, everyone. It's been an extraordinary few months since we last spoke. Before we start, I want to say that I hope you and your families are healthy and that you've been able to adjust to the new normal that COVID-19 is creating for all of us.

This crisis has been heartbreaking to witness as it unfolds across the globe. It's a tough time for everyone, and the uncertainty about how long it will last and what life will be like afterward makes this time even harder. I've witnessed a lot in my 40-plus year career in the insurance industry, but this health and humanitarian crisis, which quickly became a threat to the world economy, is like nothing any of us has experienced. We believe COVID-19 will be the single largest CAT loss the industry has ever seen, and it will continue to have significant global economic ramifications for the foreseeable future.

Having said that, it's been heartwarming to see the compassion and empathy that has emerged. The strength of the first responders, health care providers and other essential workers on the front lines risking their lives to help others and the people all over the globe sharing resources and helping each other are some examples of how we've come together to fight a common enemy. In many ways, this crisis has shown us that we had more in common than we do differences.

AIG is not immune to this health threat. We've been fortunate to have a relatively small number of colleagues who tested positive for COVID-19. Our hearts go out to them and particularly to the families of a few who sadly passed away.

Insurance companies play an important role during times of stress by helping companies and individuals manage risk and reassess risk appetite. The industry leadership AIG has demonstrated over the last couple of years continues, and we will take a leading role in helping clients and other industry partners manage through this unprecedented time.

Turning to the topic of this call. I want to thank you for joining us. Our team is working remotely so we are in different locations this morning. In addition to my remarks, you'll hear from Peter, Kevin and Mark. And Doug Dachille, our Chief Investment Officer, will be available for Q&A. We will lengthen today's call because we want to make sure there is sufficient time to cover our usual topics in addition to COVID-19 and we want to answer your questions.

I want to be very clear at the outset that AIG was in a strong financial position before this crisis began and remains in a strong financial position today. We have been and will continue to be laser-focused on actions to further strengthen our liquidity and capital. Our focus on fundamentals and the foundational work we have done since late 2017 to derisk AIG and prudently protect our balance sheet has served us well as we navigate this crisis. Because of this ongoing work, I believe AIG will emerge from COVID-19 stronger and more unified with greater perspective, wisdom and gratitude.

Crisis reveals character, and our leaders across AIG have shown incredible strength of character as they help colleagues adjust to new working conditions, assess what we need to do to keep AIG operating seamlessly and focus on what we do best, which is helping our clients manage their most complex risks, especially through difficult times. Our executive leadership team in particular has navigated through many catastrophes, and they're applying their knowledge and experience as we work hard to protect our colleagues, serve our clients, keep open lines of communications with our global regulators and policymakers and generally be a good global citizen.

Our global workforce has shown tremendous resiliency over the last few months. Helping our colleagues has been top of mind for our executive team. In mid-March, we issued a \$500 grant to each colleague globally, which equates to \$30 million in the aggregate to help with unanticipated costs.

We are also focused on helping communities where we live and work. To date, we have contributed masks, gowns, gloves and other much needed personal protective equipment. As we move to remote working, we donated unused produce, perishables and dairy products from our cafeterias and pantries to local shelters and other charitable organizations. We recently reinstated the AIG Foundation, and we'll be making an inaugural \$5 million contribution. The foundation's primary focus for the foreseeable future will be on COVID-19 relief efforts across the globe.

Turning to our first quarter results. We reported net income of \$1.98 per common share and adjusted after-tax operating income of \$0.11 per common share. Although our operating results were negatively impacted by COVID-19, our net income positively benefited from successful hedging strategies in our investment portfolio. It is important to note that our core business delivered strong results, and we are taking decisive actions to ensure that we do not lose the significant momentum we had as we moved into 2020, which continued through the first quarter of this year.

While not easy, we took a very prudent yet robust approach to analyzing COVID-19 impact across AIG. This is a very unique catastrophe, and we will continue to be thoughtful and thorough as we move through each quarter while this ongoing event evolves. Forecasting the impact of COVID-19 in future quarters is difficult. In light of this, we -- and the continued uncertainty across the global economy, we are withdrawing the guidance we provided on our last earnings call, including our adjusted return on common equity outlook.

Having said that, in General Insurance, we do expect to see continued improvement in the combined ratio ex CATs for 2020. And I believe that our global capabilities and expertise, coupled with our strong capital position, will be an even greater demand when COVID-19 begins to stabilize. In Life and Retirement, while there will continue to be short-term effects of volatile markets, we do not believe that the impact of COVID-19 will result in a material reduction of our long-term return profile.

With respect to our investment portfolio, it is well matched to our liabilities and is diversified by asset class and industry sector, making it resilient to a credit downturn. Furthermore, spreads tightened through the end of April, resulting in a 70% or \$6.5 billion recapture of the mark-to-market loss reflected on our March 31 balance sheet for fixed-income available-for-sale securities.

Looking ahead, the ongoing work we are doing, particularly as part of AIG 200, will result in AIG not only emerging from this crisis as a stronger, better company but also as a global insurer of choice with significant capital and financial flexibility. I am very confident AIG will successfully move forward on its journey to become a top-performing company and a leading insurance franchise.

With that, I will turn it over to Peter.

**Peter Salvatore Zaffino**

*President, Global COO & CEO of General Insurance*

Thank you, Brian. Good morning, everyone, and thank you for joining us. Today, I plan to review the following topics: a brief overview of the potential near- and longer-term impact of COVID-19 on the insurance and reinsurance markets generally; how we analyzed the impact of COVID-19 on GI through March 31; first quarter results for General Insurance excluding COVID-19, including Validus Re, our recently announced launch of Syndicate 2019 and AIG 200; and the progress that we've made since our last earnings call.

As Brian said, the near- and long-term impact of COVID-19 on the global economy in insurance and reinsurance industries remains unclear. In contrast to other catastrophes like wildfires, hurricanes and earthquakes, this event is not confined to any specific geographic region and it had already impacted over 200 countries and territories. In addition, this (sic) [ its ] duration is not limited as is typically the case with traditional CATs.

While the insurance industry manages risk of all kinds, it's fair to say that the profound impact and global nature of COVID-19 is something we have never encountered. There's no playbook, and as a result, we are called upon to make thoughtful and prudent decisions in a climate of unprecedented uncertainty.

Before COVID, the largest catastrophes on record were Hurricane Katrina with \$65 billion losses; then the Tohoku earthquake with \$35 billion in loss; Hurricane Irma with \$30 billion losses; and Superstorm Sandy, also with approximately \$30 billion in losses.

With respect to COVID-19, we're starting to see early industry estimates, but they have significant ranges. While it's too early to gauge the ultimate size of the loss, we believe COVID-19 will result in the largest individual CAT loss the insurance industry has ever seen. Going forward, COVID-related losses will impact all aspects of underwriting insurance from absolute limits available, limits deployed to certain lines of business, terms and conditions, co-insurance and structure of coverage, just to name a few.

With respect to the reinsurance market, unlike traditional main parallel catastrophes, COVID was not modeled, and therefore, it will be a headwind for future capacity. We believe the retro market will contract. And in the ILS market, there will be trapped capital, which will lock up collateral, therefore, restricting capacity on a go-forward basis. And we're already seeing this.

At AIG, the body of work in General Insurance, which started in late 2017, has significantly improved our company's financial position and has allowed us to take a leadership position in the market. Our strategic decisions and disciplined focus on areas such as underwriting excellence, the rebalancing of our portfolio, improved rate adequacy and the strengthening of our leadership and underwriting capabilities, coupled with the addition of Validus in a comprehensive and revamped reinsurance program, has served us very well and enabled us to preserve capital and provide more predictable outcomes aligned with our risk tolerance. AIG is well positioned to be the insurer that clients turn to for advice on risk and risk management issues, and our partnerships with distribution have continued to strengthen as we problem-solve risk issues through this challenging time.

Turning to General Insurance. Before reviewing our first quarter results, I'd like to address the loss estimate we booked for COVID-19. As Brian noted, we spent a considerable amount of time analyzing our potential exposure across multiple lines of business and geographies. Given that COVID-19 initially emerged from outside the U.S., we saw claims from Asia, the U.K. and Continental Europe and later in the first quarter from the United States, in each case, predominantly in travel and contingency.

As you saw in our earnings release, our estimated total COVID-19 net CAT loss in the first quarter was \$272 million, which includes significant IBNR. We reached this estimate notwithstanding that there is uncertainty as to how this ongoing event will evolve and ultimately impact our insurance. It is far from clear, at this stage, the extent to which those impacts will even result in covered losses. Having said that, we did think it was incumbent upon us to come up with a loss estimate for the first quarter.

Let me take you through the process we undertook to arrive at this estimate. Over the past several weeks, we pulled together a multidisciplinary team of professionals at AIG with significant industry expertise and experience in underwriting claims, finance, actuarial and reinsurance. This team did a top-down and bottom-up policy level review of every account with activity in the first quarter as well as a review more generally across our portfolio. Due to the significant claim activity we saw in travel and related accident and health losses, I want to provide more detail on this aspect of our estimate. On a global basis, after applying expected reinsurance recoveries, our estimate was \$86 million.

An important point to note is that we have a sliding scale commission structure in travel, which will result in acquisition expenses being reduced by approximately \$50 million during 2020 based on our first quarter loss estimates. Therefore, you should think of our \$86 million first quarter net loss estimate for travel and related accident health as closer to \$36 million. The remaining \$186 million of the estimate relates to contingency, commercial property, trade credit, workers' compensation and Validus Re.

This estimate also encompasses potential losses arising from business interruption coverage in our commercial property policies. As to those policies, I want to emphasize that the overwhelming majority contain exclusions for losses related to viruses and otherwise require a showing that the virus caused direct physical loss or damage that was the cause of the business interruption. We are confident these exclusions and related terms and conditions will be upheld should they be challenged.

In the small fraction of commercial property policies where we have provided affirmative coverage for infectious disease, we've done so under strict underwriting guidelines, offering small sub-limits with terms and conditions limiting coverage, in many instances, only to certain specified diseases and regardless, only where it can be shown that the disease was physically present and led to a governmental suspension of the business operations.

Additionally, our reinsurance program will help protect our portfolio from COVID-19 losses. And depending on the line of business, geography and size of loss, our net exposure will be significantly limited.

Lastly, I want to note that there's been a fair amount of attention to various U.S. legislative efforts to retroactively impose coverage for COVID-19-related business interruption losses, notwithstanding the clear terms and conditions in commercial property insurance policies. We are confident that these efforts will not be broadly successful or survive constitutional scrutiny.

Turning to the rest of the first quarter. As I said earlier, we had a very good result in our general -- core General Insurance business with continuing momentum and profitability improvement. The adjusted accident year combined ratio improved 60 basis points to 95.5% year-over-year primarily due to a 100 basis point improvement in the loss ratio. Our expense ratio increased marginally as a function of lower net premiums earned, although on a year-over-year basis, we reduced general operating expenses by approximately 8%, reflecting our continued focus and discipline on expenses.

North America's adjusted accident year combined ratio for the first quarter improved 180 basis points year-over-year, reflecting the improved quality of our North America portfolio. Highlights in the quarter included lower attritional and severe losses in U.S. retail property and Lexington property, and PCG experienced lower attritional losses, reflecting improvements in this portfolio. We had strong new business in the quarter, highlighted by admitted and non-admitted property and lead mid-market casualty. In addition, North America leadership team remained focused on expenses and reduced general operating expenses by 10% year-over-year while continuing to invest in talent.

International's adjusted accident year combined ratio was flat year-over-year. The loss ratio decreased due to improved rate and portfolio optimization actions. We had strong performance in Japan, Asia Pacific commercial and the U.K. The portfolio actions we took led to reduced net premiums so the expense ratio was higher, although, in dollar terms, general operating expenses decreased 6%.

Throughout the first quarter, we saw a meaningful acceleration in rate year-over-year across the portfolio. These rate increases are in addition to those we saw beginning with the first quarter of 2019 and continued to strengthen throughout last year. Overall, rate improvement excluding Validus and Glatfelter was low double digits, with North America having the strongest rate strengthening with low double-digit rate increases. In North America, areas that we focused on for improved financial performance included excess casualty, which achieved over 30% rate increases; financial lines overall and D&O specifically, which achieved over 20% and 40%, respectively; and wholesale Casualty and Property, which achieved 30% rate increases.

Rate increases in international were also strong with high single-digit increases. Europe, the U.K. and the Middle East achieved the strongest rate increases in our international portfolio. In U.K. financial lines, we saw rate increases of over 15%, D&O was over 20%. Our U.K. and Middle East and Africa Specialty portfolios achieved 20% rate increases, and in Europe, overall, we were able to achieve high single-digit rate increases led by our Specialty and motor portfolio.

Net written premium was down approximately 1.5% year-over-year after adjusting for foreign exchange impact, which was in line with our expectations. COVID-19 had a limited impact on our net premiums written in the first quarter, with

the exception of a falloff in travel and M&A during the month of March, which were the first areas to be impacted by the pandemic.

Net premiums earned were \$6.1 billion in the first quarter compared to \$6.7 billion in the first quarter of 2019. This decline was due to the impact of our casualty and energy quota shares earning through and improving the overall mix of business as well as reflecting the impact of lower gross underwriting and discontinued business.

Turning to Validus Re. Gross premiums written were up 15% as our team continued to execute with disciplined underwriting and a focus on areas of rate improvement and better terms and conditions. With respect to April 1 renewals, our Japan portfolio achieved strong risk-adjusted rate improvements. Rate increases of 35% to 55% on Japan wind business occurred for non-loss impacted business, and loss impacted layers were up between 75% and 100%.

Validus Re increased premiums written while derisking its portfolio in lower layer business. Specifically, Japan premium increased 13% year-over-year while Japan wind PMLs decreased by approximately 15% at the 1 in 100 year return period. The risk-adjusted rate increase at April 1 for international property was 15%.

Moving to our PCG business. Yesterday, we announced the official launch of our strategic partnership with Lloyd's called Syndicate 2019, which is now accepting new and renewal business. Syndicate 2019 is managed by Talbot and is dedicated to supporting our U.S. high and ultrahigh net worth business. This innovative business model is another example of actions we have been taking to derisk and reposition our portfolio, reduce volatility, preserve capital and strategically pursue profitable growth. Syndicate 2019 is an important step forward for PCG and allows us to reposition the portfolio and reduce peak zone and concentration risks, which are inherent challenges with a portfolio of this nature.

We were pleased with the support Syndicate 2019 generated from highly regarded third-party investors and capacity providers, many of whom have partnered with us and supported the broader General Insurance turnaround since late 2017. In addition, Syndicate 2019 provides us with an alternative solution to traditional reinsurance, thereby reducing overall reinsurance costs of PCG and for the core program for AIG.

Our PCG business is a recognized market leader, and the new management team that we put in place in 2019 is making significant and excellent progress in improving the financial and operating performance. We continue to execute on a disciplined underwriting strategy in the first quarter with PCG achieving meaningful rate increases across the portfolio, which we expect to continue through 2020.

Turning to AIG 200. Despite the all-hands-on-deck crisis management work related to our COVID-19 response, our team continued to make significant foundational progress on the operational programs I outlined in our last earnings call. AIG 200 remains a top priority for us even more so now. As we discussed on our last call, after a robust bottom-up exercise, we identified 10 operational programs designed to achieve transformational change by focusing on 4 core objectives: underwriting excellence, modernizing our operating infrastructure, enhancing user and customer experience and becoming a more unified company.

Since that call, the world changed dramatically. The AIG 200 leadership team, together with other leaders across AIG, did a truly incredible job in the early days of COVID-19. The speed at which we were able to move validated that we have the right people in the right roles to take our transformational program to the next level. As we reposition our global colleagues to a work-from-home environment literally within days, we learned a tremendous amount about our systems and end-to-end processes.

While our overall targets of achieving \$1 billion in run rate savings by the end of 2022 with a cost to achieve of \$1.3 billion have not changed, we are adjusting the timing and sequencing of certain operational programs based on recent learnings. For example, we are accelerating work related to AIG operations, which includes our shared services platforms. We now have significantly more data about our ability to connect our various platforms and confirm that we can operate in a more virtual and agile model in a post-COVID world. We believe this will allow us to achieve greater efficiencies in the near term and to more flexibly source requisite skills needed to enable us to operate in a more effective manner.

With respect to IT transformation, we completed the design of a simple, more efficient IT organization and also finalized our plans to modernize and simplify our application portfolio. The last few months confirmed that our planned digital, virtual target state is appropriate for our businesses and will give us the opportunity to enhance efficiencies and effectiveness.



Turning to our standard commercial underwriting platform. We moved into the testing phase, and we'll be launching an end-to-end model office where we can further test our new digital underwriting technology and prepare to scale IT across our commercial business. While we're still in the early stages of executing on AIG 200, we're even more committed to this critical strategic effort that will position AIG for long-term sustainable and profitable growth.

Lastly, I want to thank our colleagues. During times of crisis, AIG's purpose is clear, and our colleagues had gone above and beyond to help each other and to support our clients and other stakeholders. I'm proud and grateful for all that they're doing, their professionalism and collaboration and for their dedication to our mission.

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

**Kevin Timothy Hogan**

*Executive VP and CEO of Life & Retirement*

Thank you, Peter, and good morning, everyone. Today, I will discuss overall Life and Retirement results for the first quarter and our current outlook, changes in our operating environment due to COVID-19 and then briefly comment on the results for each of our businesses.

Life and Retirement recorded adjusted pretax income of \$574 million for the quarter and delivered adjusted return on attributed common equity of 8.4%. Adjusted pretax income decreased by \$350 million year-over-year primarily due to significant market stress in March compared with the strong market recovery we saw in the first quarter of 2019. The main driver of the decrease was lower equity market returns, which primarily resulted in higher variable annuity reserves of \$161 million and higher deferred acquisition cost amortization, DAC, of \$138 million.

Also, widening credit spreads generated lower returns from fair value option bonds of \$116 million, and the low interest rate environment resulted in continued spread compression across our individual and group retirement product lines. Lastly, I am pleased to report that our hedge program performed as expected in response to the market stress experienced in March, generating gains exceeding the movement in our economic view of the liability and related cash collateral.

Recognizing the limits of sensitivity, especially in the context of first quarter's market volatility, our sensitivities provided on our last earnings call generally held up. Based on the environment we see today, we continue to expect base spread compression across the whole portfolio of approximately 8 to 16 basis points annually. However, wider risk-adjusted credit spreads should generate opportunities to attract new business at profitable margins, and the reinvestment of assets rolling off the portfolio should benefit from higher credit spreads.

We have updated our estimates of market sensitivities to reflect our balance sheet as of the end of the first quarter. We would expect a plus or minus 1% change in equity market returns to respectively increase or decrease adjusted pretax income by approximately \$25 million to \$35 million annually and a plus or minus 10 basis point movement in 10-year treasury rates to respectively increase or decrease earnings by approximately \$5 million to \$15 million annually. These sensitivities assume the immediate impact of market movements on reserves, DAC and fair value option securities as well as investment income and other items.

It is important to note that these market sensitivity ranges are not exact nor linear since our earnings are also impacted by the timing and degree of movements as well as other factors. Market conditions began to improve in April, but one can expect that should conditions continue to improve, there may be immediate benefits in reserves, DAC or investments in the second quarter, although these benefits are likely to be offset slightly by lower private equity returns that are reported on a 1 quarter lag.

Despite the challenging environment COVID-19 created, our balance sheet is strong, and we currently estimate our fleet risk-based capital ratio for the first quarter to be between 405% and 415%, including both the impacts of variable annuity reserve and capital reform as well as our hedging program. Our risk-based capital ratio will be sensitive to the impacts from COVID-19 as they flow through our balance sheet throughout the year. Market stress in the first quarter due to COVID-19, while severe in nature, did not reach our modeled stress testing scenarios, although we recognize there is uncertainty in front of us.

Although we expect lower levels of overall industry sales for the foreseeable future due to impacts from COVID-19, our leadership position continues to provide us with a unique competitive advantage. We have a broad position across variable, indexed and fixed annuities, term and permanent life insurance, not-for-profit retirement plan markets and

institutional markets. We are not dependent on any one product type or distribution channel, which allows us to maintain our long-standing disciplined approach with respect to product pricing and future development regardless of the economic environment. Over many years, we have proven our ability to redirect our marketing efforts from one product type to another as market needs and pricing conditions change.

We also have a large and diverse in-force portfolio that does not have the significant risks associated with pre-2010 living benefits for long-term care. Our very small block of remaining long-term care business has been reinsured to Fortitude. Our strong capital levels and broad market presence position us well to deploy capital as potential attractive opportunities arise in this widening spread environment.

Now I'd like to touch on our operations over the last few months. As Peter noted, we transitioned quickly to a remote working model. With the support of our regulators where needed, we successfully adapted our e-signature policies, procedures and controls to support the needs of our plan sponsors, distribution partner firms and individual customers.

Also, investments we have made to enhance our digital capabilities have served us well as many more customers are taking advantage of our enhanced self-service tools.

We've also been very responsive in adopting changes to address the financial hardship faced by some of our customers, such as extending the grace period for premium payments and meeting the requirements of the CARES Act. Our sales and relationship management professionals quickly shifted from face-to-face to virtual meetings and have conducted thousands of such meetings and educational webinars with our producers and customers.

Turning to our first quarter financial results. As mentioned, the primary drivers of the decline in Life and Retirement total adjusted pretax income were short-term impacts to our individual and group retirement businesses from significant market movements. As to the top line results for individual retirement, premiums and deposits decreased primarily due to significantly lower fixed annuity sales as we maintained our pricing discipline as treasury rates dropped throughout the quarter, with credit spreads only beginning to widen late in the period. Our indexed annuity sales remained strong, but we again grew variable annuity sales. Lower sales of fixed annuities resulted in negative net flows for total individual annuities.

For group retirement, premiums and deposits decreased due to lower new group acquisitions as well as reduced individual product sales driven by the uncertain environment. Net flows improved year-over-year primarily due to lower group surrenders. In this period of uncertainty, we expect fewer plan sponsors to change providers, which may reduce new group acquisitions but would support plan retention.

For our Life Insurance business, total premiums and deposits increased due to higher international premiums. Our mortality trends continued to be favorable to overall pricing assumptions, and the first quarter included a modest IBNR reserve strengthening to reflect the fluidity of COVID-19. Although we may experience some acceleration, we are not expecting large incremental impacts to mortality rates and expect any incremental impacts to be manageable in the context of our overall balance sheet.

For Institutional Markets, we have continued to grow our asset base and earnings, and this business continues to be well positioned. We remain focused on new opportunities and have the capacity to participate as activity arises in the pension risk transfer and other institutional businesses.

To close, despite these challenging times, we remain available to serve our customers, plan sponsors and distribution partners. We are committed to further mobilizing our broad product expertise and distribution footprint to serve our stakeholders in new ways as their needs evolve. We will continue to deploy capital to the most attractive opportunities and focus on meeting ever-growing needs for protection, retirement savings and lifetime income solutions.

Now I will turn it over to Mark.

**Mark Donald Lyons**  
*Executive VP & CFO*

Thank you, Kevin. Before providing summary comments about the first quarter, I'd like to give a COVID-19 perspective from where I sit. First, this health crisis which quickly evolved into an associated financial crisis is unprecedented in scope, uncertainty and length and depth of economic impact.

Additionally, this ongoing event has simultaneously impacted both sides of the balance sheet, thereby nullifying most underlying assumptions that investment assets and insurance liabilities are marginally correlated. As a result, it's extremely difficult to forecast one quarter in advance, let alone a full year longer. However, as Brian also noted, I want to reiterate that AIG was strongly financially positioned entering the crisis, both from a parent and subsidiary liquidity and capital perspective, and is well positioned today, including our investment portfolio.

The evolving situation causes us to view liquidity and capital strength as an imperative. When the crisis suddenly took hold on capital markets in mid-March and not knowing what could come next, we thought it was prudent to augment our already strong current liquidity with a \$1.3 billion partial drawdown of our revolving credit facility. We did this solely as a precautionary measure given the significant uncertainty at the time about the near-term impacts of COVID-19. I will provide an update on our capital management plans and liquidity position later in these remarks after I review our first quarter results.

So turning to the first quarter. AIG reported adjusted after-tax operating earnings of \$0.11 per diluted share compared to \$1.58 per share in the first quarter of 2019. Contained within this result is the continued improvement of General Insurance with a 95.5% accident year 2020 ex-CAT combined ratio, as Peter noted. First quarter results reflect direct and indirect impacts related to COVID-19, including the market impact on net investment income and book value, with a lesser impact on core operations APTI.

Peter discussed the General Insurance COVID reserve reflects our best estimate for losses occurring through March 31. For the first quarter, adjusted book value per share increased 2.8% and adjusted tangible book value per share increased 3.2%, both since year-end. It's also notable that AIG's adjusted tangible book value per share increased nearly 11% since March 31, 1 year ago (sic) [ 2019 ], which we believe is a better measurement of the improvement in AIG's core operating performance over the last year. Book value and tangible book value per share, both of which include changes in AOCI and the DTA, were virtually flat year-over-year even with the significant AOCI change we saw in the first quarter of this year.

In the first quarter, on an adjusted pretax income basis, net investment income or NII was \$2.7 billion, down approximately \$1 billion from the first quarter of 2019. Recall that the first quarter of 2019 included significant gains following the downturn that occurred in the fourth quarter of 2018 and this year's first quarter experienced significant losses due to the COVID-19 volatility in March, resulting in a distorted quarter-over-quarter comparison.

I want to spend some time on our global investment portfolio because, in the current environment, I think it's important to understand its composition. Several reports have been published that used incorrect assumptions and information about our portfolio. In many cases, our consolidated global portfolio has been compared to U.S. Life or P&C peers or the industry generally without taking into account our unique position as a global composite or multi-line insurer. In addition, some believe our portfolio has above-average inherent risk, which is simply not the case. Instead, we believe our portfolio is below average in terms of risk, and we'll get into some of that.

In addition, certain accounting elections AIG took in prior years relating to specific securities have created above-the-line accounting volatility, which has led to some confusion, but this volatility does not impact AIG on a total return basis. To address these complexities and the many questions and comments we have received, we've provided much more disclosure regarding our portfolio, including the General Insurance, Life and Retirement and Legacy portfolio composition, on Pages 46 through 65 in our financial supplement. There, you will find a significant expansion of our disclosure beyond segment and into credit quality distribution and asset or industry characteristic.

As Brian mentioned, Doug Dachille, our Chief Investment Officer, can help address follow-up questions during Q&A, but I'll give some high-level comments now. At March 31, AIG had a \$332 billion investable asset portfolio. This portfolio is about 73% fixed income available-for-sale securities, which represents 75% of General Insurance's portfolio and 74% of Life and Retirement. In addition, roughly 14% of the portfolio is invested in mortgage and other loans, 6% in short-term investments, 2.5% in real estate investment, less than 2% in private equity, approximately 1.5% is in the fair value option fixed income securities or FVO securities and about 0.7% is in hedge funds.

It's important to recognize though that roughly 80% of the FVO fixed income portfolio, which historically has had higher volatility than our available-for-sale fixed maturity securities, is held in legacy. Notably, the FVO portfolio makes up only 1.4% of General Insurance's portfolio and 0.3% of Life and Retirement.

Our historical FVO accounting election, mostly on Legacy non-agency RMBS that were previously credit impaired, cannot be changed or modified and move mark-to-market volatility above the line into our income statement within net investment income. For available-for-sale securities, such volatility would be below the line in AOCI. As a result, this FVO accounting treatment puts more volatility into our income statement by NII with less relative volatility in AOCI, which is where one would ordinarily expect to see the volatility.

Financial statement geography is important to note when examining AIG's NII, but it is irrelevant when you look at total return, which is how our investment function manages our portfolio. Over the last 4-plus years, and Doug can address this in more detail, AIG has seen significant derisking of its investment portfolio with material reductions in hedge funds, life settlements, CDOs and FVO securities, totaling approximately \$32 billion, which is a 60% drop in these asset classes since year-end 2015. Additionally, AIG's portfolio has only a very small direct equity exposure, representing just 0.2% of the portfolio. The volatility in the equity markets has a minimal impact on our investment income, and even that is below the line.

On Page 63 of the financial supplement, you will also see a significant \$9 billion-plus credit quality difference in below investment-grade securities between the rating agency view and the NAIC designation view. Most of this is non-agency RMBS on an FVO basis, which we have had evaluated and rated NAIC-1 by the Securities Valuation Office of the NAIC. This is the highest rating category, which is important because these assets strengthen subsidiary RBC levels and can sustain RBC levels even if they fall one notch because they still will be investment-grade. However, rating agencies have not re-rated these securities with current information. So from their perspective, the securities still retain Legacy below investment-grade status.

When examining our \$144 million of corporate debt, which is summarized on Page 56 of the financial supplement and expanded beginning on Page 59, note that nearly \$130 million (sic) [ \$130 billion ] is investment-grade. And of this total, 15% is rated AA or AAA, 34% is A rated and 51% is BBB rated. Compared to the overall investment-grade market, we have a superior distribution of such asset by rating. Similarly, when viewing the entire corporate debt portfolio, 10% is below investment-grade, which is much lower than the market average of 28%. I wanted to point this out because given the magnitude of AIG's investment portfolio, some may assume that our portfolio mirrors the industry average, which is not the case.

With respect to CECL credit impacts in the first quarter, which are included in realized gains and losses and not NII, we recognized approximately \$236 million of credit losses. This stems from about \$198 million in fixed income securities and \$38 million in loans.

Now turning to the operating segment. As Peter and Kevin discussed their financial results in detail, I will just add a few remarks to augment their comments. General Insurance, I'd point out that the \$419 million of total CAT reserves for the quarter represents 6.9 loss ratio points with \$272 million or 4.5 loss ratio points being attributed to COVID-19 and \$147 million or 2.4 loss ratio points related to other CAT events, the largest of which was the tornado storm system that hit Nashville in early March. Excluding COVID-19, General Insurance generated \$185 million of underwriting income, which includes the non-COVID CAT losses.

Prior year development was minimal in the first quarter with \$60 million of net favorable development, \$53 million of which emanated from the amortization of the ADC deferred gain. On a pre-ADC basis, there was a net \$1 million of favorable development, representing \$30 million of unfavorable in North America, mostly from shorter tailed lines, largely offset by favorable \$31 million from international across many product lines. Lastly, as Peter discussed, Syndicate 2019 will favorably alter AIG's risk profile as concentration risk is distributed across an innovative structure and set of capital providers.

We anticipate that in the second quarter and for the balance of the 2020 year, ceded premiums will increase over original expectations, and therefore, net premiums will correspondingly reduce. We project that second quarter net written premium in high net worth will be down approximately \$650 million from original expectations and that net earned premiums for the 2020 year will reduce by approximately \$675 million as a result. Beginning in 2021, however, the catastrophe cover costs will decrease for AIG since the high net worth exposure subject to the CAT program will be a fraction of what it is today. So for 2020 underwriting income for the high net worth unit, we anticipate approximately the same underwriting result pre and post 2019 and then to become accretive thereafter.

Turning to Life and Retirement. I would just add that Institutional Markets benefited from approximately \$700 million pension risk transfer premium in the quarter, albeit down a bit from corresponding quarter of last year. In Legacy, the \$368

million adjusted pretax loss in the first quarter was due to a reduction in NII driven by capital markets volatility we saw in March, which abated, as mentioned, in April.

As a reminder, we signed a definitive agreement to sell Fortitude last year with the economic set as of December 31, 2018, which means that all net income subsequent to year-end 2018 up through closing will be included in the gain on sale -- or loss on sale to be recognized upon the closing of the transaction. We continue on course towards a midyear closing, subject to regulatory approval. And it is noteworthy that Fortitude also has benefited from strategic hedging transactions that performed as expected and, in fact, helped capital ratios remain virtually unchanged since early 2019.

Next, moving to other operations. And as I discussed on last quarter's earnings call, you will see on Pages 37 to 39 of the financial supplement a revised and simplified presentation that helps identify key drivers of APTI. Our previous disclosures on this segment could be difficult to understand and volatile in part due to the gross up of income and expense for internal items, mostly investment services, which increased other income and GOE. We simplified that and also provided APTI by activity, which should help. As for magnitude, this quarter's \$280 million of other operations GOE included the COVID-19 employee grants totaling \$30 million that Brian referenced and remote access IT costs of \$3 million. Excluding that, other operations GOE would have only been \$247 million.

Turning to tax. We had a core 23% tax rate on adjusted pretax income for the first quarter, higher than recent prior quarters due to additional items dominated by a \$37 million impact reflecting share-based compensation differences caused by grant date versus delivery date of value resulting from stock price declines during the first quarter.

Turning to liquidity and capital resources. We believe that liquidity and operating subsidiary capital strength are paramount priorities in this uncertain economic environment. At year-end 2019, AIG had \$7.5 billion of liquidity at the parent, and the RBC fleet ratios for General Insurance's U.S. pool finished 2019 at 419% and for Life and Retirement at 402%.

During the first quarter, we repurchased \$500 million of our stock and called \$350 million of Formosa bonds. Share repurchases helped to offset share count dilution stemming from equity compensation, and the Formosa bond calls aided our debt leverage ratio. As of March 31, AIG had a similar \$7.5 billion of current liquidity, including the \$1 billion -- \$1.3 billion draw from our revolver that I referenced earlier in my remarks as well as strong liquidity in both General Insurance and Life and Retirement.

Before turning to AIG 200, there were 2 below-the-line items in the first quarter that I would like to highlight. First, the success of our hedging program, and the second would be Blackboard. Turning first to our hedging program. Roughly \$3.6 billion of variable annuity fair value benefits were reflected during the first quarter within the realized gains line as a direct result of successful interest rate and equity risk hedging within the Life and Retirement and Legacy segments that clearly preserved book value. It should be noted though that on a GAAP basis, this gain was aided by the NPA or nonperformance adjustment impact, which is highly volatile and reversible depending upon rate spreads in equity markets.

Secondly, at the end of March, AIG made a strategic decision to discontinue Blackboard, our internal insurance tech start-up, in light of current market condition. Blackboard's GOE, which was \$16 million in the quarter, has been historically recorded in other operations, but that will cease starting with the second quarter of this year. Associated with this business decision, we recorded an approximate \$165 million after-tax charge not included in APTI.

Pivoting to AIG 200. As Peter noted, we continue to refine our operational plans in response to COVID-19. We still expect that this strategic 3-year transformation will result in \$1.3 billion in costs to achieve an annualized \$1 billion of run rate GOE savings by year-end 2022.

Let me first just provide a quick review and then I'll give you the AIG 200 3-year walk as well as its impact on the first quarter of 2020. From a reporting perspective, all costs to achieve aside from \$400 million of pretax spending that will be capitalized will be recorded below the line, not in APTI, as restructuring and other costs, which will make it straightforward to track. These below-the-line charges mostly involve employee-related costs, dedicated internal resources and associated professional services (sic) [ fees ].

Capitalized costs of \$400 million before tax represent mostly investments in systems development, interfaces, data conversions and associated integrated workflow processes, which have an impact on cash but are not expensed immediately in the income statement. Instead, each investment will be capitalized and then amortized through GOE based on its useful life according to accounting principles. Hence, by year-end 2022, we would expect that the amortization portion of the \$400 million will be included in our annual expense run rate, where our goal is a total annual run rate savings of \$1 billion, including the amortization of these capitalized investments.

So let's turn towards what this means for the next 3 years, acknowledging that in this uncertain world, timing of plans can somewhat change. Under Peter's leadership, we are governing AIG 200 via structured checkpoints and tollgate to control costs, confirm scope -- and reconfirm scope and drive key milestone achievements. Overall, we expect a total "cash cost" at the holding company of \$1.3 billion.

As shown on Page 8 of the financial results slide, \$350 million of this is expected in 2020, although still being reviewed due to COVID-19 impact, \$500 million in 2021 and \$450 million in 2022. Of these amounts, approximately \$100 million in 2020 will be capitalized with later amortization into GOE. The combination of these 2 results in a below-the-line projected charge of \$250 million before tax. Then in 2021, about \$200 million will be capitalized with a below-the-line charge of roughly \$300 million. And finally, about \$100 million will be capitalized in 2022 with a below-the-line charge of \$350 million.

Based on our current useful life schedule for depreciation and assumptions about when we expect the \$400 million in capitalized assets to be placed into service, calendar year depreciation included in GOE should be 0 in 2020 as the project will still be in development, rising in 2021 to be between \$10 million to \$15 million before tax and \$25 million to \$30 million in 2022. Based on projected completion by year-end 2022, the unamortized balance of about \$350 million will be amortized at about a 7-year average life, with \$50 million per year in 2023 through 2027 and then trailing off a bit from there.

Finally, in the first quarter of 2020, we had a \$90 million restructuring charge below the line, of which about \$23 million related to AIG 200 and the balance from other actions. Going forward, restructuring charges will primarily reflect AIG 200 costs. Relative to expense savings, this quarter had \$10 million of GOE savings, which will translate to \$60 million on an annualized run rate basis, which is part of the \$300 million planned run rate benefit by year-end 2020.

Now shifting to capital management and looking ahead. In light of the significant uncertainty on many fronts due to COVID-19, we do not plan to do additional share repurchases or debt reduction actions for the foreseeable future, but we will reassess this as COVID-19 impact stabilizes. However, given improved stability in and access to the capital markets since March, we are reevaluating our debt and capital plan. While reducing debt leverage to 25% or below is a minimum term goal, in the near term, our priority is maintaining strong operating capitalization, financial flexibility and liquidity. As a result, we are considering options to generate additional near-term liquidity in light of ongoing economic volatility as well as upcoming debt maturities in 2020 and in the medium term.

Although spreads have widened since year-end, all-in coupons are attractive. And given the significant uncertainty around the duration and depth of global recession created by COVID-19 as well as taking into account our global operating footprint and different regulatory capital regimes, we think it is prudent to evaluate debt capital market opportunities in the near term rather than waiting until later in the year, which was our original plan prior to COVID-19.

Lastly and reflecting back, the first quarter benefited in the first 2 months from strong momentum in GI pricing, investment return and operating initiatives. In March, COVID-19 spread incredibly fast and dramatically changed everyone's everyday world. AIG entered this crisis from a position of strength. While it has certainly impacted us and caused us to recalibrate some of our plans, AIG is more resilient than it has ever been with strong leadership and greater portfolio and risk management across the organization. We are confident in our ability to weather this storm and look forward to being able to engage with you again in person, hopefully, in the near term.

With that, I will turn it back to Brian.

**Brian Charles Duperreault**  
*CEO & Director*

Thanks, Mark. Abby, I think we're ready for the Q&A portion. So please get us started and let us know who's first.

# Question and Answer

## Operator

[Operator Instructions] And we will take our first question from Elyse Greenspan with Wells Fargo.

### **Elyse Beth Greenspan**

*Wells Fargo Securities, LLC, Research Division*

My first question -- in your prepared remarks, you guys mentioned that a small fraction of your commercial property policies contain coverage for infectious diseases and that those policies do have small sublimits. I'm just trying to get a sense for those policies where you think you could see losses, have you set up reserves within your COVID losses in the first quarter?

### **Brian Charles Duperreault**

*CEO & Director*

Okay. Elyse, I think that's a question for Peter. Peter, would you take that, please?

### **Peter Salvatore Zaffino**

*President, Global COO & CEO of General Insurance*

Yes. Sure, Brian. Elyse, let me just give you a little bit more detail. Yes, we did go through it very thoroughly in the first quarter, as I outlined our process that we did, bottom-up and top-down. But when you look at the size and scope of our global portfolio, the nature of our clients in terms of the segmentation, we do have commercial property policy that have some manuscript wordings. As I said in my opening remarks, the overwhelming majority of the standard commercial property policies do contain clear exclusions for viruses, and it's fairly standard in the industry. These policies also require that there's direct physical loss or damage that impact the insured business operations. As to these policies, COVID is not covered. So that's point one.

There are limited instances where we do write affirmative coverage for communicable diseases. But even in those cases, it's only on a supplemented basis and it's pursuant -- we have very strict underwriting guidelines that often result in coverage for only specified diseases and in an event that there's a requirement that there would also be a government closure caused by physical presence of the disease itself. So again, it's fairly clear.

And just to give you some context in terms of what I'm talking about, is that 100% of our sublimits aggregate to well less than 1% of our total limits in our commercial property policy. So it's a very small portion of the overall property exposure. And I would just note that I mentioned in my prepared remarks, we have really comprehensive reinsurance, whether it's on a property per risk basis. We have low attachment points on a per occurrence basis, that's regional, and we also have global aggregates that attach to reduced volatility on a frequency and severity basis. So sorry for the long answer, but I think it's important to get into the detail.

### **Brian Charles Duperreault**

*CEO & Director*

Thank you, Peter.

## Operator

We will take our next question from Tom Gallagher with Evercore.

### **Thomas George Gallagher**

*Evercore ISI Institutional Equities, Research Division*

Mark, you mentioned your plan on running with higher debt for the time being, which I think that makes sense given the current environment. Have you gotten any sense from the rating agencies on their reaction to the higher leverage for now?

And then just a follow-up question on the investment portfolio. Appreciate all the disclosure there. The \$18 billion of other invested assets, it looks like \$6.7 billion of that is in legacy. Would you expect most of that to be transferred with

the Fortitude resale? And then sorry for the string here, but then just one related question. The \$8.5 billion of real estate alternative investments, should we expect there to be any kind of impairment on that in 2Q? Or is there some buffer with historical cost accounting there?

**Brian Charles Duperreault**  
*CEO & Director*

Okay, Tom. Listen, why don't we have Mark, you want to talk about the debt. And then I'm going to ask Doug to take over on the investment portfolio question. So Mark, why don't you go first.

**Mark Donald Lyons**  
*Executive VP & CFO*

Sure. Thank you, Brian, and I will do that as well. With regards to debt, yes, we've spoken to the rating agencies. In fact, we were in conversation with them on the revolver drawdown, as a matter of fact, and had very good strong and supportive conversations with them. And anything, in the future, we may contemplate, of course, we'll be in discussions with them as well.

With that, I will turn it over to Doug to ask -- to talk about those 2 investment questions.

**Douglas Adam Dachille**  
*Executive VP & Chief Investment Officer*

Thank you, Mark. Well, I would refer you to Page 49 of the financial supplement, which basically goes through the Legacy segment and the assets that are kind of held in that segment in pretty robust detail.

As you know, in addition, there's approximately \$40 billion of assets, which we also disclosed in our financials, which are going to be part of the sale related to Fortitude. The portions that we'll be retaining -- there will be some real estate investments that we'll be retaining that are part of Legacy. There will also be some fair value option bonds that will be retained in Legacy that were part of the old financial products direct investment book. So those will not be part of the sale transaction. But the material amount of the assets will be -- as you know, over \$40 billion will be separating as part of the sale of Fortitude.

With respect to the real estate, as you know, we only experienced a rapid acceleration in the month of March with respect to the development and emergence of the COVID situation. So we're still in the midst of analyzing the impact, and I think it's very early to determine what the impact will be on our real estate portfolio. But it should be noted that our real estate portfolio is diverse. It includes both domestic and international exposures. So the impact, we'll learn more as things go on.

I think where we're learning the most about our real estate is obviously on the commercial mortgage loan side. So that's where we're getting some real insight into what's going on in the real estate market. And those teams, the commercial mortgage loan team, work very, very closely with the real estate equity team at AIG. And all of those investments are managed directly, so we have great level of sight -- of line of sight to what's going on in that market. But it's still really early to determine what's going to happen.

**Brian Charles Duperreault**  
*CEO & Director*

Okay. Thanks, Doug.

**Operator**

We will take our next question from Yaron Kinar with Goldman Sachs.

**Yaron Joseph Kinar**  
*Goldman Sachs Group Inc., Research Division*

I want to start with one question on the removal of the 2021 in terms of return guidance. Just want to make sure I understand what it does and what it does not mean. Does it mean from your perspective that you could see the COVID impact linger or continue well into 2021?

**Brian Charles Duperreault**  
*CEO & Director*



Well, let me take that. Who knows? I mean you don't know whether COVID will reemerge, if it does go down and impact in 2020. It's really a question of how much predictability is there to quarterly earnings. And it's difficult to predict quarters. So if you can't predict a quarter, I don't want to try to predict a year or several years. I think it's important to note, though, that the underlying power of the company remains. We're very, very strong in the GI. GI has continued to show improvement, the good work that has been done over the last 3 years, what Peter and his team have continued on. So the returns that we were talking about, I believe, if you -- certainly, if you take the COVID out for a second, are going to continue to improve. And so the trajectory we're on is we're still on. Now you have a COVID event, and I think the COVID event certainly would impact L&R on a short-term basis. But again, we think the long-term power of the company is there.

So COVID itself, it'll be large. I told you that I believe it will be the largest event in the insurance industry. But it is a -- it's an inflection point, and that effect that we'll see -- we've already been in a market on the GI side, General Insurance, P&C side. That was turning. It was improving. And the rates and terms and conditions were improving for the risk taker. This COVID is going to prove to be an inflection point. So companies with strong balance sheet, we have one. Companies with strong management, we have one. Companies that have been well risk managed, and we've done that now, they're going to be on the right side of that. And so we believe we can handle anything that comes with COVID, and we feel very strong, but predicting quarter-to-quarter is just impossible. So I hope that helps.

**Yaron Joseph Kinar**

*Goldman Sachs Group Inc., Research Division*

Yes, it does. So my follow-up question on that is when you talk about COVID being the largest catastrophe event in the industry's history, can you maybe talk about what P&C lines in particular you would foresee having very large losses here and maybe also the proportion of losses that you'd expect coming from L&R, maybe not directly COVID related but from capital markets activity?

**Brian Charles Duperreault**

*CEO & Director*

Well, I'm going to have Peter talk about what we see in the P&C side, and then I'll let Kevin talk about L&R. So Peter, do you want to talk about that first?

**Peter Salvatore Zaffino**

*President, Global COO & CEO of General Insurance*

Sure. Thank you, Brian. We mentioned quite a few lines when we were referring to the first quarter, whether it's travel, M&A, A&H. Some other lines to think about that could have activity is workers' compensation. We don't know about D&O liability. We have been watching it very carefully and making certain that we're looking at any line that we think could have an impact. But I mean what I can tell you, to add to Brian's comments before, is that we have a very thorough process and we'll be consistent all the way through.

We know the CAT is still ongoing, which is a very rare. So as things emerge and develop, we will adapt to that. And we're looking at this across every global geography where we think there's impact and multiple lines of business. But because the CAT is still going, we even have 2 months left in the quarter, it's hard to see what may transpire in the future. But as I said, we have a great process, and we'll keep everybody updated on lines of business as they emerge.

**Brian Charles Duperreault**

*CEO & Director*

Kevin, the L&R?

**Kevin Timothy Hogan**

*Executive VP and CEO of Life & Retirement*

Yes. Thanks. So I'll address it really in 3 pieces, mortality in the markets and then maybe just a reminder around pricing.

So our reported mortality in the first quarter was below pricing, which continues the trend that we've had for the last 2-plus years. But later in the period, what we did notice is that there were some delays in reporting generally related to the issuance of certain documentations. So we put up a modest IBNR really to just add late-running reporting. As we look ahead, we do expect that there will be additional mortality in the second and the third quarter depending upon how circumstances and behaviors evolve. So where does that leave us? We expect some adverse mortality overall for 2020,

but we don't expect to see significant impacts to the balance sheet just based on what we know, and there could be some offsetting factors.

In terms of the market effects, look, there's 2 things. I mean when equity markets move, particularly when they go down, that ultimately reduces our future expected fee income, particularly in the annuities portfolio, which we have to reflect immediately and back. And the reality is that the reduced reserve overall actually emerges as additional profits in the future and also serves to increase our SOP 03-1 reserves. And when changes in credit spreads, we see the immediate impact on fair value options.

So those 2 short-term market effects are reversible, and that leads to the third thing, which is pricing and how do we feel about current pricing. And certainly, treasury rates are at all-time lows, but our ability to price product is to pace -- is based not only on where base rates are but also where credit spreads, what is the shape of the yield curve and where investor expectations and appetites are. And so based on the current environment, we're still able to price to long-term expectations that we have. Certainly, there's disruptions in the sales environment, but it's difficult to anticipate what the future on that is going to be and how it evolves.

So those are the 3 perspectives I have on the long-term earnings potential of the Life and Retirement.

**Mark Donald Lyons**  
*Executive VP & CFO*

And one thing I'd just like to add there, Yaron, to Peter's comments about certain lines of business, he mentioned workers' comp. I think it's important to remember that AIG has de-risked that workers' compensation business significantly probably over the last 7, 8 years. And where AIG finds itself now is mostly in loss sensitive-related programs, which have average deductibles north of \$1 million. So when you think about deaths in the work comp area, that's statutorily determined by state. That's going to be underneath a deductible. Standard medical and temporary, all that falls away. It has to be a major permanent partial to really penetrate it. So I think the book is well positioned given what we're talking about here.

**Brian Charles Duperreault**  
*CEO & Director*

Yes. And just one other piece on the comp. And Peter mentioned this earlier, but we -- yes, there are COVID claims coming in, but I think you have to recognize that there's been a decline in a number of claims coming in otherwise. And so it remains to be seen what the net effect of COVID has on the workers' comp. So that's something to keep an eye on.

**Operator**

We will take our next question from Michael Phillips with Morgan Stanley.

**Michael Wayne Phillips**  
*Morgan Stanley, Research Division*

I want to touch on comments on expected continued underwriting core profitability in General Insurance and maybe how you think about the near-term impact of exposure drops given the economy and how that might affect the profitability improvement plan for the remainder of this year.

**Brian Charles Duperreault**  
*CEO & Director*

Okay. Michael, well, that's Peter. So Peter, why don't you do that?

**Peter Salvatore Zaffino**  
*President, Global COO & CEO of General Insurance*

Okay. Thank you for the question. We certainly are paying very close attention to lines of business that would be affected by the economic headwinds that are generated from COVID-19. I mentioned some of them in the prior question in areas where we're watching for loss, but I would think that there's going to be a meaningful falloff of travel in the second quarter, M&A, could be some falloff in aerospace, marine and energy and we mentioned workers' compensation.

Having said all that is that you got to remember the segmentation and demographic of our portfolio. I mean over 75% of our business is on some form of either deductible SIR or funded captive. And so we don't have a direct correlation.

Even though it is rated off of a payroll, sales, auto is done on an excess basis. And therefore, we do not think we will have as much headwind in terms of premium reduction. There will be some, but it'll be more modest because it's not a direct ratable exposure that generates a premium. We have different factors in terms of how we adjust excess premium. So we just don't think it's going to be as pronounced.

Brian mentioned on workers' compensation the decrease in frequency. It's not a trend yet, but it's an observation that while COVID losses are increasing, we're seeing a commensurate drop in where our clients are retaining losses, that those are dropping. So as we look at repositioning our portfolio, where we attach on an excess basis and a commensurate premium, as I said, there's going to be some lines of business that will affect, but we think there's opportunities for other areas of growth. As we have repositioned the portfolio, we like where we are and think that the leadership position that AIG can demonstrate in the marketplace will give us also some select opportunities for growth.

**Brian Charles Duperreault**  
*CEO & Director*

Thanks, Peter. Michael, anything else?

**Michael Wayne Phillips**  
*Morgan Stanley, Research Division*

No. That's it. Appreciate it.

**Brian Charles Duperreault**  
*CEO & Director*

Okay. Thanks, Michael.

**Operator**

We will take our next question from Paul Newsome with Piper Sandler.

**Jon Paul Newsome**  
*Piper Sandler & Co., Research Division*

I'm a little concerned that the loss with the -- the big CAT loss that you have from COVID-19 is more of a liability loss than a property loss. Can you talk about how the reinsurance would protect you in a liability-type catastrophe event versus a property-type loss? I'm familiar with the [ loss type to property ], but I can't recall a liability to cash being done with this in terms of size. So I don't know what you guys mean in terms of coverage protection from that loss.

**Brian Charles Duperreault**  
*CEO & Director*

Okay. So Paul, you want us to talk about COVID versus our reinsurance program?

**Jon Paul Newsome**  
*Piper Sandler & Co., Research Division*

Yes. If COVID was a liability loss instead of a property loss.

**Brian Charles Duperreault**  
*CEO & Director*

Yes. Okay. Well, Peter, I guess that's you again.

**Peter Salvatore Zaffino**  
*President, Global COO & CEO of General Insurance*

Yes. Thanks, Brian and Paul. So I outlined our property program and said that we had reduced volatility significantly. On the liability side, I think we've done actually even more. We used to retain significant limits within AIG, and so we've been building a program over time that significantly reduce the net limits that we put out as well as the gross limits. And also, we did it on an excess of loss basis and also on a quota share.

So on a general liability policy, as an example, we would have less than probably -- depending on the limit, we have a 50%-plus quota share on our first limit retention, and we have 100% reinsurance above \$25 million. So we have -- if you issue a policy, a significant-sized policy, the most you'll have in that is between \$10 million and \$12 million. So we actually have significant protection on the quota share as well as the excess of loss.

**Brian Charles Duperreault**

*CEO & Director*

So Paul, let me just jump in. Look, again, our reinsurance is good and solid, and Peter has done a tremendous job along with his team to put that together. Our first line of defense is the way we manage our portfolio to start with. And so you can't rely on reinsurance to make a portfolio better than it is. So we've done a tremendous amount of work, risk selection, limits management, attachment points and pricing along all the lines of business, property and casualty. And that's where we feel very confident about our situation vis-à-vis the impact that COVID will -- as those impacts unfold. So I just want to add that.

So Paul, did you have another -- anything else?

**Jon Paul Newsome**

*Piper Sandler & Co., Research Division*

No. That's it for me, the reinsurance.

**Brian Charles Duperreault**

*CEO & Director*

Okay. Thank you.

**Operator**

Our next question is from Ryan Tunis with Autonomous Research.

**Ryan James Tunis**

*Autonomous Research LLP*

I just wanted to confirm something that, I guess, Peter said earlier in the Q&A that there's affirmative BI coverage for 1% of total property limit. That sounds like that could be somewhat of a big notional number. Did I hear it correctly?

**Peter Salvatore Zaffino**

*President, Global COO & CEO of General Insurance*

Well, what I said was...

**Brian Charles Duperreault**

*CEO & Director*

Peter, you go ahead. Peter, go ahead.

**Peter Salvatore Zaffino**

*President, Global COO & CEO of General Insurance*

All right, Brian. Ryan, what I said was not that, that was a permanent coverage and those sublimits would trigger coverage. What I said is that the limits that we provided on the affirmative, which have, again, a bunch of triggers that I outlined in my previous answer, that we have well less than 1% of our total limits when you compare that to our property gross limits. So again, it's well less than 1%. And I'm not suggesting that we confirm that there is coverage or that we are adjudicating claims on that amount. It's just that that's what we have for limits, and then it goes case-by-case, insured-by-insured in terms of what the loss is.

**Brian Charles Duperreault**

*CEO & Director*

Yes. Ryan, let me just add something here. And that is, Peter talked about that process of evaluating the losses occurring in the first quarter. I've been in this business a long time, 40-plus years, and I've seen a lot of things come and go. I've seen difficulties in trying to assess loss. I have to tell you the process that we went through, that they went through and

we went through, it's as good as anything I've ever seen. They have gone through every bit of the portfolio. They looked at everything where there was a potential and evaluated whether there would be a reason to put up a reserve. If there was, it was done. So we have posted the reserves that we believe are appropriate, albeit conservative, for that -- everything that happened in the first quarter. I just want to make sure that everybody understands that. Let me...

**Ryan James Tunis**  
*Autonomous Research LLP*

Yes. Yes. So can you just talk a little bit about how you're seeing business interruption losses might respond within the Validus book? And also, just the \$272 million net loss number, what does that look like on a gross basis in reinsurance?

**Brian Charles Duperreault**  
*CEO & Director*

Okay. Well, Peter, that's you again. Okay.

**Peter Salvatore Zaffino**  
*President, Global COO & CEO of General Insurance*

Okay. With Validus Re, we've gone cedent by cedent, have taken a look at our gross net exposures and put up what we thought was the best estimate based on, again, the same process that we outlined for the core of AIG in the first quarter.

In terms of the net and gross, I mean, look, there's some reinsurance. I'm not going to go into great detail in terms of what the net is versus the gross. It's still an evolving loss, as we outlined, with meaningful IBNR. But again, I've outlined what I thought were the reinsurance structures that could apply in the event that the loss were to grow over time.

**Brian Charles Duperreault**  
*CEO & Director*

Okay. Thanks, Ryan.

**Operator**

We will take our next question from Meyer Shields with KBW

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

This is sort of a related question, but it seems to be top of mind for a lot of investors. How should we think about commercial property where there is no affirmative coverage but not virus exclusion given some apparent court decision saying that non-personal damage would qualify?

**Brian Charles Duperreault**  
*CEO & Director*

Well, it's a technical question, Meyer. But Peter, can you do it?

**Peter Salvatore Zaffino**  
*President, Global COO & CEO of General Insurance*

It's a really hard question to answer because it's hypothetical. The only thing I can really do is comment on the policies that we have and where we think -- again, I outlined the demographics of it and think that the exclusions that we have and where we've granted affirmative coverage, it's very specific. And so it's hard to answer that because I don't think it really applies to our portfolio.

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

Okay. That's fair. Unrelated question. I guess I would have expected maybe better results in international personal lines, assuming an international shelter-in-place order. Am I missing something there?

**Brian Charles Duperreault**  
*CEO & Director*

International personal lines, Peter?

**Peter Salvatore Zaffino**

*President, Global COO & CEO of General Insurance*

Yes. What happened in international personal lines, it's not an anomaly, but we basically had a runoff program that impacted -- and we still had earned premiums. So it was put into runoff in 2018, unearned premium in '19. And as we've been doing the re-underwriting of the portfolio, again, not as much as we did on the commercial, we've just lost a little bit of premium. And so the ratios look like they -- perhaps they're not going in the right direction. But the absolute performance is very strong. We like the personal book very much and think that there are some real discrete opportunities for growth, particularly in A&H and an area across all of international and actually have a new digital platform we're putting in. So I wouldn't read into that in terms of a trend. It's just the impact of a runoff business, Meyer.

**Brian Charles Duperreault**

*CEO & Director*

Thanks, Peter. Thanks, Meyer.

**Operator**

Our next question is from Brian Meredith with UBS.

**Brian Robert Meredith**

*UBS Investment Bank, Research Division*

Yes. So Brian, I'll have this one for you instead of going to [ others ]. Given the impact we've seen of COVID-19 on the General Insurance business as well as the Life Insurance businesses, I'm wondering if you're at all rethinking the strategic rationale of actually having both the Life and the P&C operation in the same company.

**Brian Charles Duperreault**

*CEO & Director*

Well, Brian, I guess my job is to continually always think about the structure that we have. Does it make sense? Would we be better in a different structure? And so that thinking continues. I think at this point, we're comfortable with where we are, but that's my job as we continue to do that. So we'll continue to keep looking at that. There were reasons why these 2 belong together, and those are still there. But I'll always think about that. But there is nothing that I would talk about. Right now, I think we're comfortable with it.

Any other question, Brian?

**Brian Robert Meredith**

*UBS Investment Bank, Research Division*

Yes. Just one other quick one here. I'm just thinking about it. So given this is, as you were saying, the largest catastrophe loss for the insurance industry probably ever, if I kind of think back, AIG with KRW had well over \$2 billion of losses. Are we talking about a potential loss here that's going to be well north of \$1 billion for you guys? Ultimately, at the end of the day, is it truly the largest capacity loss ever?

**Brian Charles Duperreault**

*CEO & Director*

Well, if you look at it, we're not the company we were, huh, Brian. We're not the company then. There's been a complete change in how we look at the risk. The derisking that we've done, the limits management, the improved reinsurance profiles all lead us -- put us in a position where we are much stronger and able to withstand an event. And so I point out that this is the largest event because I want people to understand that it's creating an inflection point in the industry. But there are going to be some who do well in this process and some that won't. We're in -- we believe we will do well through this event and that we will -- we're going to emerge stronger and more in demand than we were before.

**Operator**

We will take our next question from Andrew Kligerman with Crédit Suisse.

**Andrew Scott Kligerman***Crédit Suisse AG, Research Division*

On the Life Insurance side, I'm wondering if you could give a bit more of a sensitivity in terms of the COVID-19 exposure, what you might expect during the course of the year. And then with regard to your variable annuity hedging that was very strong, what was your hedging effective numbers with variable annuity?

And lastly, just in terms of the press release and what you said on the call, you talked about maintaining the return on equity profile for the Life business. What might that profile be? I mean could you [ run through ] where you think a good range [ could be ] and where the Life and Retirement business could be?

**Brian Charles Duperreault***CEO & Director*

Okay. Andrew, thanks. So I'm going to have Kevin and obviously talk about the sensitivity around COVID-19 and the hedging program. On the hedging program, I think, Kevin, why don't you do the piece about the variable annuity? But I would like Doug to jump in on the -- what happened with Fortitude as well. So Kevin, why don't you start?

**Kevin Timothy Hogan***Executive VP and CEO of Life & Retirement*

Yes. Thanks, Brian. Thanks, Andrew. So look, I guess I'll address that from a couple of perspectives. I covered the market impacts, the short-term market impacts, so I'm not sure -- I need to go back to that. But I mean, clearly, when equity markets move, it impacts the SOP in the DAC. And when the fair values move, that impacts the fair value options. Those will unwind.

**Andrew Scott Kligerman***Crédit Suisse AG, Research Division*

On [ Life ], I meant simply the mortality...

**Kevin Timothy Hogan***Executive VP and CEO of Life & Retirement*

I'm sorry, Andrew?

**Andrew Scott Kligerman***Crédit Suisse AG, Research Division*

Yes. I apologize. I needed to be clearer. I meant simply the mortality, what is your sense just given the mortality...

**Kevin Timothy Hogan***Executive VP and CEO of Life & Retirement*

Oh, mortality. Fine, yes. So it's very straightforward that in the first quarter, we saw mortality better than pricing. We believe there are delays in the reporting of those claims. As we look at second quarter and third quarter based on where the current estimates are, this is well within our first level modeled stress scenario. We don't expect any significant impact on the balance sheet. And there's also -- it's difficult to project how people are going to behave, how people are going to respond. So that's about the best that we can do. It's just based on where we believe our market presence and geographical presence are versus the current expected losses.

In terms of hedging, what I would say is, first of all, you can only hedge what you have. And so the liability profile that we have is a big part of the success of our hedging program because we have primarily derisked benefits sold well after the VA arms race of the mid-2000s. And so that includes our feature of requiring fixed-income allocation, volatility, control funds, et cetera. We've hedged all hedgeable market risks. We've left an open position relative to credit spread because we believe that, that is a natural hedge against our general account portfolio. Over time, our hedge effectiveness is around 90%, and it's continued to perform almost exactly as we expected in the various market dynamics, resulting in, I think, the results -- the good results we reported for the quarter.

But I'm going to pass on to Doug because another feature of our hedging success in the first quarter was also in the Fortitude portfolio.

**Douglas Adam Dachille***Executive VP & Chief Investment Officer*

All right. Thank you, Kevin. So I just wanted to comment on the fact that what you don't really see in the financials is with respect to the Legacy segment, you're seeing all the mark-to-market impact, particularly of the fair value option securities that are in Legacy and, to some extent, in Fortitude. What you don't see is the fact that we had established interest rate and credit hedges which all that P&L and effect goes through realized capital gains and losses. So you don't really see the net effect.

But the best way to look at how that -- how the entity performed and how those hedges are formed and how effective they were is as Mark made in his prepared remarks, he said that the regulatory capital ratios for the entity were preserved from over a year ago. So that gives you a sense of how effective our hedging strategy was for things that you're not necessarily seeing when you look at the mark-to-market volatility that is reported in our financial statements in the APTI. So thank you.

**Brian Charles Duperreault***CEO & Director*

Okay. Thanks, Doug.

**Operator**

Our next question will be from Scott Frost with State Street Global Advisors.

**Scott Frost***State Street Global Advisors, Inc.*

You said you expect COVID be the largest single P&C event the industry has ever seen. Could you give us some background on what the basis is for this assessment, specifically the length of shutdown you're assuming here? And what are your thoughts on the Willis piece released Friday? And over how many years do you expect claims to develop and be paid? I'm assuming multiyear payment profile. But if I'm wrong, please correct me.

**Brian Charles Duperreault***CEO & Director*

Okay. Well, let me start with that and then Peter can add from it. But in terms -- just in terms of the payments, these particularly business interruption claims are very long in process and payments. So I think we're just -- I think we just cleaned up the last business interruption from Superstorm [ Irma ], to give you some idea. So anyway. But in terms of the estimate, I mean, we've seen a lot of different estimates, and I think they run the range. But the first thing you have to understand is this is global in nature. This pandemic has affected every corner of the world. It isn't that hard to come up with a reasonable assumption around the effects because we're seeing effects in Europe, we're seeing effects in Japan, we're seeing effects in Latin America and, of course, here in North America. So whether it's the effects of comp that we talked about or it's the business interruption, with travel and event cancellations and on and on and on, it doesn't take much to figure out how this has spread across the globe. The question for us is what's our position on all those things? And we feel very, very comfortable with how we've managed this risk in general and how we're well positioned for COVID.

Peter, do you want to add anything to that, where does the...

**Peter Salvatore Zaffino***President, Global COO & CEO of General Insurance*

Brian, not much. The only thing I would just add is what you said. We've seen a lot of very good written documents that have come out. But just because of the ongoing nature of the event and the complexity of the different lines of business, it's the wide range of scale in terms of the low end to the high end is about as wide as you'll see in terms of predicting cash. So it's very hard to pinpoint anything or the level of accuracy until this evolves over time.

**Scott Frost***State Street Global Advisors, Inc.*

Well then, how can we say that it's going to be the largest event we've ever seen when there's a wide range? I mean, again, you're saying it's going to exceed Katrina. So on the basis of that, what -- I mean, again, what are we saying? I mean the Willis report says length of shutdown is really the determining factor. They're saying a year at \$80 billion. When



you say it's greater than Katrina, is that the basis of your statement? Or can it be less than that? I mean what I'm trying to get at is how are you getting to that statement? Do you see what I mean?

**Brian Charles Duperreault**

*CEO & Director*

Peter?

**Peter Salvatore Zaffino**

*President, Global COO & CEO of General Insurance*

Yes. I mean so looking at -- I mean, let's get off the Willis is that we've done a ground-up analysis based on what we think can be an industry loss with a lot of assumptions, again, length of time, severity, geographic spread, and have done it across multiple lines of business. And again, we're not in the business of putting out ranges as to what is going to happen to the industry because we look at our own portfolio. But when we look at market share of different lines of business, we came up with an estimate that exceeded Katrina. And I think that was the basis of Brian's statement.

**Brian Charles Duperreault**

*CEO & Director*

Yes. Okay.

**Scott Frost**

*State Street Global Advisors, Inc.*

But it would be helpful if you could -- if you told us some of the assumptions behind that is what I'm driving that. I appreciate the comments.

**Brian Charles Duperreault**

*CEO & Director*

Well, thank you very much. Like I said, we've gone past our time, so I want to wrap this up.

And so first of all, I want to thank everyone again for joining us today. And I also want to thank our clients and distribution partners, our shareholders, other stakeholders. We're all in this together, and we will get through this challenging time together. Most importantly, finally, I want to thank our colleagues around the world. Guys, you've exceeded my expectations, and I could not be prouder of what we've accomplished together over the last few months.

So everyone, please be safe and be healthy. And thank you again. Goodbye.

**Operator**

Ladies and gentlemen, this concludes today's call, and we thank you for your participation. You may now disconnect.

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