S&P Capital IQ

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The Allstate Corporation NYSE:ALL

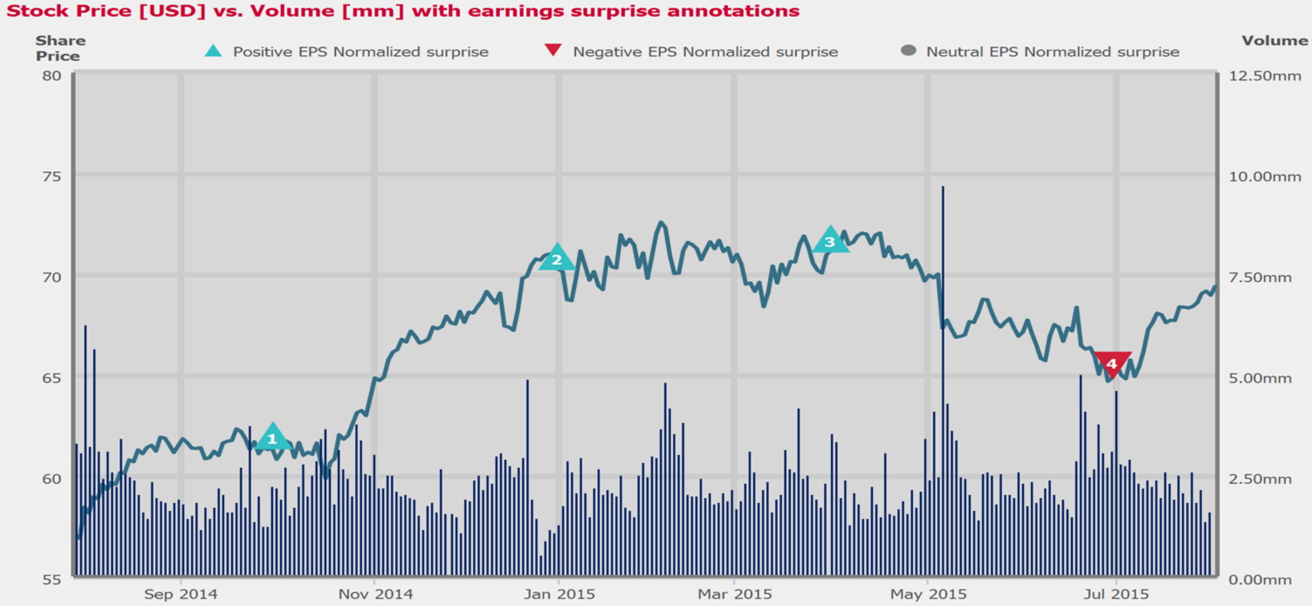
FQ3 2015 Earnings Call Transcripts

Tuesday, November 03, 2015 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2015-			-FQ4 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.30	1.52	▲16.92	1.41	4.93	5.57
Revenue (mm)	7634.24	7650.00	▲0.21	7706.36	30305.99	31544.77

Currency: USD
Consensus as of Nov-03-2015 11:55 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2014	1.32	1.39	▲1 5.30 %
FQ4 2014	1.68	1.72	▲2 2.38 %
FQ1 2015	1.42	1.46	▲3 2.82 %
FQ2 2015	1.02	0.63	▼4 (38.24 %)

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Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Allstate Third Quarter 2015 Earnings Conference Call. [Operator Instructions] As a reminder, today's program is being recorded.

I would now like to introduce your host for today's program, Pat Macellaro, Vice President of Investor Relations. Please go ahead.

Patrick Macellaro

Thank you, Jonathan. Good morning. Welcome, everyone, to Allstate Third Quarter 2015 Earnings Conference Call. After prepared remarks by Tom Wilson, Steven Shebik and myself, we'll have a question-and-answer session.

Yesterday afternoon, we issued our news release, filed our 10-Q for the third quarter and posted the results presentation we will use this morning, along with our Third Quarter 2015 Investor Supplement. All these documents are available on our website at allstateinvestors.com.

Our discussion today will contain forward-looking statements regarding Allstate's operations. Allstate's results may differ materially from these statements so please refer to our 10-K for 2014, the slides and our most recent news release for information on potential risks. Also, this discussion will contain some non-GAAP measures, for which there are reconciliations in our news release and our investor supplement.

We're recording this call and the replay will be available following its conclusion. I'll be available to answer any follow-up questions you my have after the call.

Now, I'll turn it over to Tom.

Thomas J. Wilson
Chairman & CEO

Good morning. Thank you for investing time to keep up on our progress at Allstate. I'll cover an overview of results and then Pat and Steve will go through the details. Our operating team is also here to provide additional perspective when we get to the dialogue section.

Let's begin on Slide 2. We had good overall earnings this quarter, primarily reflecting the continued strength of our Homeowners Insurance business. As you know, we repositioned this business so the underlying combined ratio would support good annual returns even with high catastrophe losses. This quarter, we also benefited from lower catastrophe losses than this quarter last year.

This continued strength in Homeowners has also let us to reduce the capital requirements for this line, which has now become a competitive advantage. We also made progress in improving auto insurance returns. As you know, in the first quarter of last year, the combined ratio on this business began to rise, which reflected an increased frequency of losses and higher severity per claim. As a result, we instituted a comprehensive program based on the business model and practices that have been highly successful, really, in the last 14 years. That, of course, includes raising auto insurance rates. For the first 9 months of 2015, the approved rate increases, this is in absolute dollars, was about twice the amounts achieved in the average of the 2 prior years. That increase in improved rates has begun to be realized in premiums earned, but of course, the impact will continue to increase over the next year as policies renew.

We also made underwriting standards more restrictive, which has the effect of reducing the higher-loss ratio of new business. As a result, Allstate brand's auto policy growth declined at 3.1% with larger reductions at Esurance and Encompass.

Given the cost trends we and others are experiencing in auto repairs, there's also a heightened focus on both effectively and efficiently managing claim loss costs. We also reduced advertising expenses and took some other actions so the underwriting expense ratio in the quarter declined by 1.4 points to 24.9%. Now all of these actions are well-thought-out. We balance short-term profitability and long-term economic value creation for shareholders. In addition, they are tightly integrated and implemented in a highly targeted and local manner.

The recorded combined ratio for the quarter is 93.6, which generated $491 million of underwriting income. The underlying combined ratio for the first 9 months of 2015 was 89.1. That's slightly above the outlook we established at the beginning of the year of 87 to 89. We now expect the full year underlying combined ratio to be no higher than 89.5. Common shareholders will receive $2.6 billion in cash so far this year due in part to an 8% reduction in the number of shares outstanding.

If you move to the box on the bottom of the slide, operating income was $610 million or $1.52 per share, which is 9.4% higher than the prior-year quarter, which you can see in that little red box. Premiums earned were up 4.7%, reflecting an increase in average premiums and a 2.3% increase in the number of items in force. The overall return on equity was 12% on both an operating and net income basis.

Let's move on to Slide 3. We'll go through the results for the individual segments. Our 5 operating priorities for the year are shown at the top and those have not changed. At the Allstate brand and lower left is our largest segment, of course, and it comprises about 90% of premiums written and serves customers who prefer branded product in value, local advice and assistance. This business continued its moderate growth across all the product lines, as you can see from the first line in that box. Total policies in force are 2.5% higher than last year's third quarter.

Auto insurance growth did decline slightly in the quarter. Homeowners policy growth was up slightly and other personalized policies grew at 3%. The underlying combined ratio for this segment was 88.3, as you can see in the red box at the bottom. Esurance on the lower right serves customers that prefer branded product, but are comfortable handling their own insurance needs.

Growth continued to slow in the segment and was 3.7% versus the prior-year. The reduction in auto insurance growth is a percentage -- is absolute. It was not offset by the high percentage growth in another product lines, such as the homeowners insurance. The underlying loss ratio did improve and was 105.3 for third quarter.

Encompass in the upper left is the smallest segment that we underwrite for and competes for customers that want local advice, but are less concerned about the choice of insurance company. Encompass primarily sells a package to auto and homeowners insurance policy through independent agencies. This business have gotten smaller and policies in force were down 5.7% from a year ago due to lower retention and less new business. We took aggressive action to improve profitability in both auto and homeowners insurance. The underlying combined ratio was 90.9 for the quarter.

Answer Financial on the upper right serves brand-neutral self-serve customers and competes in a relatively small segment of the market that, which -- with aggregators such as Google Compare. Total non-proprietary written premiums of $443 million for the first 9 months of 2015 are 11.2% above the same period in the prior year.

That overall operating results were in line with our expectations and we remain committed to increasing shareholder value by generating good returns, growing profits and providing cash to shareholders.

Pat will now go through the Property-Liability results in more detail.

Patrick Macellaro

Thanks, Tom. Let start by taking a look at the Property-Liability P&L on Slide 4. Starting with the chart on the top of the slide, Property-Liability net written premium was $8.1 billion in the third quarter of 2015. It was 4.2% higher than the third quarter of 2014, reflecting the combination of policy and average premium increases predominantly from Allstate brand auto and homeowners. The first 9 months of 2015, net written premium grew by 4.5%, while policies in force grew by 2.3%.

Property liability policies in force were $34.7 million at the end of September. You should note that this excludes $5.6 million Allstate Financial policies and $2.1 million Good Hands roadside relationships.

Catastrophe losses of $270 million in the third quarter of 2015 were $247 million lower than the prior-year quarter. Recorded combined ratio for the third quarter of 2015 was 93.6, which is 1/10 of a point worse than the prior-year quarter. The first 9 months of 2015, the recorded combined ratio was 95.8, which was 6/10 of a point worse than the first 9 months of 2014.

The underlying combined ratio for the third quarter of 2015 was 89.3 and the underlying combined ratio for the first 9 months of 2015 was 89.1, both elevated over the results we experienced in 2014. Property-Liability operating income of $550 million in the third quarter of 2015 was 0.5% below prior year result, while the $1.3 billion of operating income through the first of 9 months of 2015 was 5.9% below the first 9 months of 2014.

Bottom of the slide contains growth trend information as well as a view of the Property-Liability recorded and underlying combined ratio trends.

Premium and policy growth trends are in the chart on the bottom left. We mentioned the drivers of premium trend shown in the blue line earlier. The red line represents policy in force growth and shows the slowing policy growth trend that's being driven by auto profit improvement actions in all 3 brands. Policy in force grew by $772,000 or 2.3% from the third quarter of 2014.

Exhibit on the bottom right displays the property liability recorded and underlying combined ratios for the third quarter of 2015. Both the recorded and underlying combined ratios were impacted by higher auto losses in the third quarter of 2015 versus the prior-year quarter.

Slide 5 highlights the margin trends for Allstate brand auto and Allstate brand homeowners.

Chart on the top left to the slide provides a view of quarterly underlying margin performance for Allstate brand auto. Third quarter results were impacted by higher frequency and severities that the prior-year quarter resulting in a 5.2 point deterioration in the underlying combined ratio from what we experienced in the third quarter of 2014.

On a sequential basis, the combined ratio was 3/10 of a point higher in the third quarter of 2015 versus the second quarter of 2015. The chart on the right highlights the trends driving the change in the underlying combined ratio.

Annualized average earned premium per policy, shown on the blue line, is beginning to pick up momentum given rate increases implemented throughout 2015. Average underlying losses and expenses per policy increased compared with the third quarter of 2014 influenced by higher frequency and severity, but lower expenses per policy. Similar information is shown for Allstate brand homeowners on the bottom of the slide.

On the bottom left, you can see the impact of low catastrophes in the homeowners recorded combined ratio, which was a 72.5 in the third quarter of 2015. The underlying combined ratio is 60.9 in the third quarter of 2015. It was 9/10 of a point higher than the prior-year quarter and about equal to this year's second quarter. On a trailing 4-quarter average basis, the underlying homeowners combined ratio was a favorable 61.8.

The components of the third quarter homeowners underlying combined ratio are in the chart on the bottom right. The average earned premium per policy increased to $1,079, or 1.5% over the prior-year quarter. Underlying losses and expenses per policy increased 3% in the quarter compared to the third quarter of 2014, but the difference between premium and underlying losses and expenses per policy is essentially the same in the 2 periods.

Slide 6 provides an update on our multifaceted auto profit improvement plan. Last quarter, we discussed the 4 components of our plan to lower auto margins, 3 of them to adjust the higher accident frequency and 1 of them to adjust the higher claims severity.

First, we saw a higher -- we saw an approval for higher auto rates across the country in response to higher loss trends. Second, we implemented underwriting changes wherever we identified specific underperforming segments of business, including ongoing correct classification programs to accurately price policies. Third, we focused on claims operational excellence and precision given costs trends. And fourth, we reduced expenses across the organization.

While these actions in total will improve auto margins, they will also slow growth. Detailed results for these initiative are shown in the bottom 2 tables.

Allstate brand approved auto rate increases in the third quarter of 2015 were 1.6% of prior year-end total Allstate brand auto net written premium or $277 million. This brings the total for the year to 3.4% or $600 million in net written premium. An outcome of these profit actions that auto growth in the Allstate brands is beginning to slow.

Property-Liability expense ratio decreased by 1.4 points in the third quarter of 2015 compared to the prior-year quarter, reflecting expense actions taken across the company. You can see the impacts by underwriting brand in the chart in the lower left.

Bottom right-hand chart shows the net written premium amounts generated by the auto rates we received approval for in the first 3 quarters for the first -- for the past 3 years for the Allstate brand. You can see to total we've implemented for the first 9 months of 2015 is significantly higher than both 2013 and 2014. We know that not every customer will renew their policy and that some customers will decide to change the level of their coverage, which will result in lower levels of premium in aggregate than what's shown on this chart. This is common customer behavior and why we believe premium change is a key process that's enhanced by an Allstate-trusted advisor. Cumulatively, the rates we received approval for in 2014 and through the third quarter of 2015 will be worth $816 million in earned premium through the third quarter of 2016.

This analysis only includes rates approved through September 30. We continue to evaluate and run our business on a local market-by-market basis. We continue to aggressively pursue rate increases and adjust our actions going forward to ensure appropriate auto returns.

Slide 7 highlights combined ratio and top line trends for both Esurance and Encompass. The chart on top of this page includes combined ratio results for both companies. Esurance's recorded combined ratio of 106.5 in the third quarter of 2015 was 10.1 point lower than the same period a year ago given decreased investment in marketing along with the 3.7 point improvement in the loss ratio. Esurance's underlying combined ratio of 105.3 for the third quarter improved by 7 points.

Encompass' recorded combined ratio of 101.3 in the third quarter of 2015 was 8.4 points lower than the prior-year quarter and benefited from an 11.1 point decline in catastrophe losses. Encompass' underlying combined ratio was 90.9 in the third quarter and 92.7 through the first 9 months of 2015.

As you can see in the 2 charts on the bottom of this page, growth is being impacted by profit improvement actions. In Esurance, policies in force and net written premium both grew by 3.7% in the third quarter of 2015 compared to the prior-year quarter. These growth rates are lower than recent quarters given impact from rate increases, underlying -- underwriting guideline adjustments and decreased marketing in select geography to manage risks. Both new business and retention in Esurance have been impacted by these actions.

In Encompass, net written premium declined by 3.5% in the third quarter of 2015 compared to the third quarter of 2014 as a 5.7% decline in policies in force was more than offset by higher average premiums from increased rates and underwriting actions. As with the Allstate brand, we continue to evaluate our results and adjust actions to ensure we're generating appropriate returns in both of these businesses going forward.

And now I'll turn it over to Steve who will cover Allstate Financial, Investments and Capital Management.

Steven E. Shebik
CFO & Executive VP

Thanks, Pat. Slide 8 provides an overview of Allstate financial results for the third quarter as highlighted on the top of the slide. Premiums and contract charges increased 5.1% when compared to the third quarter of 2014 driven by growth in Allstate benefits, accident and health insurance business as well as increased traditional life insurance renewal premiums. Operating income for the third quarter was $138 million, 10.4% higher than the third quarter of 2014. The increase in operating income compared to the prior-year quarter was driven primarily by higher returns on performance-based investments, which were partially offset by higher mortality and a lower return from the fixed income portfolio.

We reduced the maturity profile of Allstate Financial's investment portfolio in the third quarter by selling longer-term fixed-income securities that back long-dated immediate annuities.

The proceeds from these sales will be invested over time in higher-returning performance-based equity investments to improve the long-term economic results from this block of business. This will include private equity, real estate, infrastructure, timber and agriculture-related investments. Although these investments are expected to deliver higher returns, the timing of those returns is difficult to predict and will result in a greater degree of variability in our earnings. Additionally, we'll have to increase the capital allocated to this business.

While these sales generated net realized capital gains, investment and operating income will be reduced prospectively by lower yields on the reinvestment proceeds.

Moving to investments result on Slide 9. The portfolio total return shown in the chart on the top left was flat for the quarter. The consistent earnings from the interest-bearing portfolio were offset by lower valuation driven primarily by wider credit spreads disproportionally on high-yield bonds in a global equity market sell-off as you can see reflected in the chart in the upper right.

The charts at the bottom provide investment income in portfolio yields for Property-Liability and Allstate Financial portfolios. The Property-Liability yield reflects prior duration shortening and ongoing investment in the low-interest-rate environment. The Allstate Financial yield is higher and is more stable due to its longer duration and use of its cash flow primarily to fund annuity reductions.

Slide 10 illustrates the strength of our capital position and highlights the excellent cash returns common shareholders received in the quarter and over the first 9 months of 2015. We're executing our customer-focused strategy, from a position of financial strength and strategic flexibility. Our deployable holding company assets totaled $3.1 billion at September 30, 2015. Book value per common share for the third quarter of 2015 of $47.54 was down slightly from the same quarter a year ago reflecting primarily reduced net -- unrealized net capital gains.

During the quarter, we returned $920 million in cash to common shareholders through the combination of dividends and common share repurchases. We repurchased 12.9 million common shares for $798 million in the third quarter and have repurchased 8% of our beginning-of-year common shares outstanding for $2.2 billion for the first 9 months of 2015.

So at the beginning of 2011, we have repurchased 32% of year-end 2010 outstanding common shares representing an $8.2 billion return of capital to common shareholders. As of September 30, we had $1.1 billion remaining on our current repurchase authorization which is expected to be completed by July 2016. Now let's open up the call for your questions.

Question and Answer

Operator

[Operator Instructions]

Our first question comes from the line of Ryan Tunis from Crédit Suisse.

Ryan James Tunis
Crédit Suisse AG, Research Division

I guess my first question is just on expense ratio here on Allstate brand. It was down over 1 point year-over-year and I think the previous guide was you're trying to get about 4/10 of a point from your expense save initiatives. Does that imply that the expense ratio improvement should moderate from the point plus we saw this quarter over the next few? And I guess, along those lines, if trend continues to be adverse, how much room is there to further cut expenses beyond the 4/10 of a point that you've caught out last quarter?

Thomas J. Wilson
Chairman & CEO

The numbers should decline. It won't stay up at 1.4 decline versus prior. There were a couple of things that happened in there: First, we've reduced advertising expenses in the quarter because we just don't want to grow as much so there's no sense advertising if we do want to grow; secondly, there were some incentive compensation adjustments which were adjusted to the full year, which has really 9 months worth of change in it versus the 3 months. But we can talk about the things we're doing. Matt can mention what we're doing to keep overall expenses in line, but it's obviously always a component of focus for us.

Matthew E. Winter
President and President of Allstate Insurance Company

It's Matt, Ryan. Thanks for the question. As Tom said, there were some one-time items that we saw in the quarter, but there were also some more systemic longer-term work that we've been doing. In addition to the advertising cuts Tom referred to, we've had a semi-year -- a multiyear effort on continuous improvement and process efficiency, which is really starting to take hold now and that's allowed us to get some increased efficiency out of this system. It allowed us to absorb some of the growth without increasing personnel costs and we should expect that to continue long-term.

Some of the cost reductions had to do with some technology costs that -- we slowed down some very long-term initiatives that we had while we make -- we retained the focus on the shorter-term ones that were essential to continuing to operate the business. So as Tom said, we won't be able to continue at the current level, but we do believe that long term, there is some additional cost reductions and efficiencies that we can continue to drive in the business.

Ryan James Tunis
Crédit Suisse AG, Research Division

Okay, that's helpful. And then just shifting gears, I guess, on frequency. I figured I'd try. I guess thinking back to last year, I think October was when we first started seeing the elevated frequency trend. I was just wondering if maybe you could comment on how this October sort of compares to when we first started seeing it a year ago.

Thomas J. Wilson
Chairman & CEO

I -- we couldn't comment on that, Ryan.

Operator

Our next question comes from the line of Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

So looking at the monthly numbers, Tom, do you see improvement in terms of the rates that you're getting in? How should we think about 4Q a little bit in terms of the trend and balance that with the seasonality of 4Q? And I know that you're not going to give us guidance for 2016 just yet, but I thought 3 months ago you were confident you could probably maintain the 89% ceiling, and I guess you're going to go a little bit above that. How should investors think about positioning themselves going forward?

Thomas J. Wilson
Chairman & CEO

Okay. You're correct in saying we'll wait until the full years is printed before we do an outlook for next year. We are -- as you point out, we had, about a year ago, actually, the frequency and severity started to take off, and as always, we're highly focused on maintaining returns on capital. That said, we always try to do that with looking at the long term economics, and of course, that's driven by retaining customers, which leads to higher profitability and higher growth. So when you have a rapid spike in cost like that, we need to, obviously, recover those costs quickly. I feel very good about the pace at which Matt and his team are executing. Don and his business are going at it. I would say, this is the first time it's really happened across the country all at once in a long time. That said, we see this movie every year, multiple times in individual states. So it's not like we haven't been through this movie multiple times before. We know what -- how to manage it. It does have an impact on growth, which you can see more dramatically in the Encompass and the Esurance brands and you see in the Allstate brand this quarter. You should expect to continue to see some impact on growth. That said, we're not doing it so aggressively that we're giving up long-term returns.

As it relates to the combined ratio and the guidance, obviously, after the second quarter, we were at the upper end of the range. We're at 89.1 versus a range of 87 to 89. We had a range of forecast at that time. We said we thought we could be at the high end of the range. We thought we still had a chance to be in the range and we continue to work aggressively to try to achieve that. That said, we did indicate we didn't think the low end of the range was achievable. Since then, we have now printed another 3 months and we're now at still at 89.1. And we also have a range of forecast. And when we look at that, we said there are some outcomes where the fourth quarter could be higher so that we can end up the full year at 89.5, which is half a point higher than the upper end of the range before. And as most of you know, the fourth quarter is historically quite volatile particularly as it relates to winter weather. But we feel comfortable that all of our forecasts are going to leave us below 89.5. So I feel good about where we're at. I think we're aggressively going after short-term actions. I don't think we're throwing out long-term value creation. That said, we're getting after it because we know that the -- the biggest driver to shareholder returns is return on equity.

Joshua David Shanker
Deutsche Bank AG, Research Division

That's great, Tom. And then just about the winter weather in the fourth quarter, I mean, I've thought about this a few times. I mean, December may have some inclement driving conditions, but it seems to me that October and November should be pretty mild driving months. How do you account for the difference maybe between fourth quarter and first quarter seasonality in the loss ratio? I would think that first quarter winter weather would be worse than fourth quarter. Or maybe I'm not thinking about this right.

Thomas J. Wilson
Chairman & CEO

I would say, there's a whole bunch of things that relate to that. Obviously, you zoomed in on weather. In addition to weather, there's the darkness. So it gets darker earlier, so more of the traffic is driven in the dark in the fall than -- and obviously, in the first quarter, but then you have weather, you have precipitation, you have near-ice conditions versus ice conditions in the first quarter. So there's a whole bunch of moving factors there. I would -- I tend to look at both of them, just say they're both highly volatile. Those are busy times of the year when people are driving a lot and you do get more actions, so there's more range. I don't think anything -- I don't think there's any El Niño effect or anything like that, that we're factoring in. It just -- it's going to be what it's going to be.

Operator

Our next question comes from line of Dan Farrell from Piper Jaffray.

Daniel D. Farrell
Piper Jaffray Companies, Research Division

Just -- I wanted to talk a bit more about the shift...

Patrick Macellaro

Dan, we lost you. Jonathan, let's go to the next question.

Operator

Our next question comes the line of Sarah DeWitt from JPMorgan.

Sarah Elizabeth DeWitt
JP Morgan Chase & Co, Research Division

On the frequency trends, has the absolute level of auto loss frequency stabilized versus the second quarter? And to what extent are you concerned that it could increase further and you'll need to take rate increases to another level?

Thomas J. Wilson
Chairman & CEO

I'll let Matt answer that question.

Matthew E. Winter
President and President of Allstate Insurance Company

Thanks for the question. Components of it have stabilized, and components of it appear to still be volatile. And so at this point, we are assuming the trend line continues to go up at its current levels. We have -- we'd like to see multiple quarters at the same level before we call it as stabilized and take our foot off the rate lever. So we continue to operate as if the frequency will continue. Our plans are to continue to take rate wherever justified and indicated and wherever we're able to in those states after we go through our examination. So I would say that we haven't leaned back and relaxed yet and said, it's all over. But it appears to be operating in an narrower range than it was, I'd say, this time last year when we saw such a out-of-proportion spike in 1 quarter.

Thomas J. Wilson
Chairman & CEO

I would add on to that. The -- what you see are our numbers across the country. Matt, and I was talking last night about certain parts of the country have not had as big an increase as other parts. So it's possible that while some portions of the country may level out, other portions may increase to catch up to where the rest of the country is. So we're -- as Matt pointed out, our team is being very cautious about calling a victory.

Sarah Elizabeth DeWitt
JP Morgan Chase & Co, Research Division

Okay, great. And then on the last call, I believe you said you thought you could get back to target auto margins of a 94% to 96% combined ratio in mid to late 2016. Now that you have one more quarter of frequency data, do you still feel confident in that?

Thomas J. Wilson

Chairman & CEO

Sarah, I remember doing the -- yes, we can get to the 94% to 96% because we ran there for 14 years. I don't remember making a call on the quarter. I think the call on the quarter will be dependent on a couple of things. The trend you just pointed out, which is, we'll have to see where that goes. Secondly, as we increase rates, we're having great success in doing that today. Our competitors are doing it. There's not a lot of noise in the marketplace yet, but if frequency continues to go up for 2 or 3 years, obviously, there'll be increased scrutiny. So we have complete confidence that we can run this business with the margin that it's been run at historically. We don't have a good, clean call as to when we'll be at that level.

Operator

Our next question comes from line of Alison Jacobowitz from Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

It's Jay Cohen, actually. Follow up on the last question, the frequency you saw in the third quarter, is it fair to say it was generally within your expectations? You weren't surprised by what you saw?

Matthew E. Winter
President and President of Allstate Insurance Company

Jay it's Matt. That's a tough question. As Tom just said, on a countrywide basis for the entire system, I would say that's accurate. I don't think there was anything that caught us off-guard. There are state-by-state geographic fluctuations in there that do continue to intrigue us. I wouldn't say surprise us, but we're trying to figure out why some the fluctuations exist in certain geographies. But overall, as a systemwide basis, I think you're right. In my opinion, third quarter was very similar to what we have seen in second quarter from a frequency standpoint. I had actually expected or hoped that we'd get a little more stabilization in some of the components. But it certainly didn't shock us or look to be a spike that was totally unexpected.

Thomas J. Wilson
Chairman & CEO

It also varies, obviously, by coverage. So we're talking about BI, bodily injury, looks a lot like the level that it started to achieve in the fourth quarter last year. Physical damage tends to be -- is a little bit higher. So as Matt points out, we're -- the good news is we have great visibility and transparency, and we act to it. The bad news is like all things in frequency, you can't predict it.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. And the second question is, what are you seeing your competitors doing now? Obviously, some have talked about higher claims trends as well. Others have not. Are you seeing a general broad competitor response at this point.

Thomas J. Wilson
Chairman & CEO

I'll give you -- so from -- what we do is we look at our numbers. We make the changes based on what's happening to our book of business so that we can earn the appropriate returns.

Matt, you might want to make a comment about what you're seeing in the marketplace.

Matthew E. Winter
President and President of Allstate Insurance Company

As Tom said, we make the call based upon what we are seeing in that market and our rate need and indication. However, in every single case, we also do run recent rate filings from our competitors to get a sense for whether or not we're out of sync or whether or not we should be looking closer at the numbers.

And what I've been seeing is, I look at those as -- that we have a broad range of our competitors taking very similar rate -- rates to us. It obviously varies depending upon their starting point, but we've seen several competitors taking much more in certain geographies and some less in others. But on a countrywide basis, I would say that we do not appear to be out of sync with our competitors, which is why in addition to the fact that our agents are able to help our customers manage through these premium increases, I think one of the reasons that retention is held and that our -- and close ratios have held is because we're not alone in this rate-taking.

Operator

And we do have Dan Farrell from Piper Jaffray back in the queue.

Daniel D. Farrell
Piper Jaffray Companies, Research Division

I apologize for the issue with the line. My question was with regard to Allstate Financial and some of the changes you're making with the shift in fixed income to risk assets. And I was just wondering, what's the lag going to be in getting some of the income from those assets? I realized there'll be more volatility. And then, secondly, you mentioned some additional capital being allocated. How do you view the ROE impact for that segment with the additional capital?

Thomas J. Wilson
Chairman & CEO

I'll provide some oversight as to the strategy and Judy can talk about the timing of income. So Dan, we have about a $5 billion block of really long-dated liability structure set out for people who are severely injured, buyout annuities, immediate annuities that have maturities of 30, 40 years. If you look at the right way to invest behind those liabilities, it would be to, a, make sure you have enough cash that in the next 5 to 7 years, you've always got enough money to pay those people. But after that, then you want to invest for long-term

return. And so when we look at that second portion, the investment pool, we said, given today's interest rates where they are, we think buying 30-year bonds to satisfy those liabilities is not the right use of our capital. That we should invest in higher-return assets. They have more volatility on an annual basis, but when you look at the volatility on a 10- or 15-year basis, it's actually lower than the volatility in investing in, in theory, lower-risk assets, like fixed income.

In doing that, though, there's a higher capital charge from the regulators. We have chosen to do the right thing long-term to generate capital for our shareholders and economics for our shareholders even though it requires putting up more capital and having a negative impact on return on equity now because we believe that's right thing to do. Judy can talk about the shift. So what we did is we sold a bunch of long-dated bonds and had some capital gains and now Judy is going to get that capital reinvested into other investments. You might want to talk about the reinvestment plan and then how long it will take to get the money back.

Judith Pepple Greffin
Former Chief Investment Officer of Allstate Insurance Co. and EVP of Allstate Insurance Co.

Sure. As Tom said, we did sell some longer-duration bonds out of the immediate annuity block. And initially, what we're doing is we're reinvesting into, primarily, public equities and shorter duration fixed income. The long-term goal, as Tom said, is to get it into performance-based assets, which we like because it's a little bit more idiosyncratic -- brings some idiosyncratic risk into the portfolio, plus we underwrite each of one of those investments and bring them in to the portfolio, as Tom said, for the long term. The kicker is that it takes a while to get the -- those investments, especially the ones that we really like, in this environment. What we're doing, though, as I said, was initially putting into this other mix, public equities and shorter duration fixed income, so we're ready when we do find those higher-performing more idiosyncratic investments.

In terms of timing, we have had some success over the past couple of years finding those investments, but what we're finding in this environment is that we're getting money back almost as quickly as we can put it out because the environment has been so favorable for realization. But we're keeping our head down and trying to find them and we'll continue to do that going forward.

Thomas J. Wilson
Chairman & CEO

So Dan, we've made the choice that choose the best long-term economics. If that has a short-term negative impact on operating income, which this will, or return on equity, that's the best choice for our shareholders because we believe in long-term, generate cash. That's what drives shareholder value and that we've decided not to be -- make economic decisions based on keeping operating earnings per share up on a quarterly basis. As long as we're transparent, we've found our shareholders to be quite receptive to that approach.

Operator

Our next question comes from the line of Bob Glasspiegel from Janney.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Allstate, I'm going to push Jay's question, which Matt answered a little bit, harder on your -- up in the range. When you were at Barclays in September, Tom, you said, if you saw anything, you would have made an adjustment by now, which I thought was sort of a pretty optimistic comment given that you'd seen 2 months of the third quarter. Was there something in the September or October that caused you to now do it? Or is there just -- is there something that isn't taking hold as quickly as you'd like. I think all your actions are right and I have 100% confidence you're going to get the underwriting back, but I just want to make sure there wasn't anything in the short-term data that caused the change from the Barclays conference commentary.

Thomas J. Wilson
Chairman & CEO

Well, when we had the Barclays conference, there was -- we have a range of projections, and those projections were largely based off what we had seen through the second quarter. So even though we're a couple of months into the quarter, you don't have things like severity and reserve changes and as clean a shot as you'd like on what the full year will look like. Obviously, get 3/4 of the way through the year, you ought to have a pretty good sense of where the year is coming out. So the range has come in some, Bob, is what I would say. It's narrowed down. The frequency, it continued to be up in the month of September, so that also impacted our view. But I don't -- it's -- don't read it as a huge change from where we were before. I was very clear, when we were at 89.1 for 6 months, we weren't going to get to 87 because we didn't think we were going run at 85 for the next 2 quarters after we'd run at 89. And so I was very clear, we're not going to be at the bottom end of the range. We still think we've got a shot at the upper end of the range. If I was -- I had a -- if I had clear indication we -- we're going to be above 89 at that point, I would've said so. We didn't have a clear indication. Now we look at it and say, we have a pretty clean indication. We're going to be below 89.5. Who knows what October, November and December will bring to us. We're constantly updating severity. There are some things that are, in terms of severities, that whether it's on the physical damage side, where given the dramatic spike in frequency, it had both stress on the number of people we have in the system. And just the system itself, body shops are busier, auto parts, so we had to kind of sort through what that was doing to cost. Matt and his team are working hard on that. And then on bodily injury, as you know, those are long-dated claims. So you want to make sure you get the reserves right. And we've -- given the bump and the volatility in both frequency and severity in bodily injury, we've had to look hard at those. So we feel good about the forecast. I don't think that you should read it as a huge change. We've provided the outlook to give you a sense of where the business is. And as you know extremely well, it's not the only impact to operating EPS, so we try to just do it to give you a sense for the business.

Robert Ray Glasspiegel

Janney Montgomery Scott LLC, Research Division

Well I had you at 89.3. So it certainly isn't a big change for my perspective. I just want to make sure there wasn't something startling in September that got you off your, "if we had changed it, we would have done it by now" comment. If I could just pivot to life with a quick follow-up. What's the size of the redeployment and what's the yield loss?

Judith Pepple Greffin
Former Chief Investment Officer of Allstate Insurance Co. and EVP of Allstate Insurance Co.

So it was roughly $2 billion long-duration fixed income. And if you look at the portfolio yield on the portfolio, Bob, it's about $560 million. These were longer-duration assets so you probably should think of them as being a little bit higher-yielding than the $560 million overall yield. And then the redeployments into 3-year corporates and equities. So you're probably looking at a proxy of around 2 1/4 at least until we get the performance-based assets into the ground.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Those are pretax numbers, right?

Judith Pepple Greffin
Former Chief Investment Officer of Allstate Insurance Co. and EVP of Allstate Insurance Co.

Yes.

Operator

Our next question comes from the line of Cliff Gallant from Nomura.

Clifford Henry Gallant
Nomura Securities Co. Ltd., Research Division

I have a question about -- I think one of your competitors in some states are allowed something called premium trend pricing. I was wondering what your comment is on that as an underwriting tool. It's pretty late in a time like this.

Thomas J. Wilson
Chairman & CEO

As an underwriting tool, Cliff, or as a pricing tool?

Clifford Henry Gallant
Nomura Securities Co. Ltd., Research Division

As a pricing tool.

Matthew E. Winter
President and President of Allstate Insurance Company

It's Matt, Cliff. Yes, I can't say that -- we've evaluated the use of monthly rating factors in the past. We continue to look at it. In some situations when you have slow and steady increase in the cost of insurance, it works to your advantage. In situations like we're in now, where you have spikes in either frequency or severity, it really doesn't do anything you can't do by just taking rate as indicated in those states. So we continue to look at it. We also know that not every state would permit it. We believe that most of the states had permitted or file in use [ph] states anyway. So if we're on top of our indication, if we're monitoring as we do on a monthly basis, we should be able to do anything that, that technique allows you to do and do it more targeted, more segmented in a more responsive fashion. That kind of puts everything in autoplay mode. Ours is more of a "hands on the wheel," mode and that's what we believe is most appropriate in times of volatility and significant changes that we have as we do today.

Thomas J. Wilson

Chairman & CEO

I think it's often -- it's interesting as you watch people analyze our results and other people's results. Everybody is looking for an answer to why. Like, why yours? Why theirs? I would say, and this is like one of these complicated 1,000-piece puzzles. There's a variety of things that we all do differently. And the thing to look at really is the way in which Matt has talked about the way we run the business in a highly targeted, highly local, highly analytical fashion. We use as many tools as possible to compete effectively and get our returns back. So I don't think there is any one silver answer as to, is it geographic spread? Is it monthly rating thing? Is a telematics? There's a whole bunch of things that go into this complicated business. I would just say, we're highly focused on making sure we make money.

Clifford Henry Gallant
Nomura Securities Co. Ltd., Research Division

Okay. If I could be allowed to follow-up. I was curious about the accident forgiveness program. Is there aren't any -- can you find any changes to that? Do think that, that might be contributing to the frequency numbers?

Thomas J. Wilson
Chairman & CEO

No. If I could just add, it's a short answer. It's just not used, the -- it's not used to such an extent. It's priced appropriately. We monitor it carefully and that's not a causal factor.

Clifford Henry Gallant
Nomura Securities Co. Ltd., Research Division

Okay, okay. And I'm sorry, I'll ask one more on Esurance. We've seen such a slowdown in the growth rate. Now I'm just curious, and from a -- how is that slowdown affecting the organization? I know sometimes -- and you have such a go-go strong growth company, and it slows it, can have an impact on the -- on how things work day-to-day.

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Yes, it's Don. Let met try to address that. I think it's an interesting twist to the question on the -- on how it's impacting the company. I mean, when we put the 2 businesses together, obviously, the strategy was to use Esurance to address the self-serve market that was still brand sensitive. The business is roughly twice the size it was when we bought it, and we've been running it with an eye towards investing for that growth. So we've said consistently, we're running it based on lifetime economic value. That said, the business is about twice the size now. And so as a larger part of the Allstate portfolio, we do want it to get to the point where that size begins to generate appropriate profitability as well. So I feel really good about where they are as a business. They had a great quarter. They're on the right path. They've done a terrific job of getting, in spite of the drop in marketing, getting the company still to grow. If you look at their combined ratio and loss ratios, they had a really strong trend over the last few quarters. Loss ratio is down pretty dramatically again this quarter. Expenses are down largely due to marketing. So I think they've done a good job. Now having said that, they're still growing. They're still expanding states. They're still expanding products. In the Q, we disclosed, we've still got almost 2.5 points of investment in expansion of their business. So I don't view this as business that should grow 3% for the rest of eternity. I think this was an important inflection point to consolidate the gains we have had from a volume point of view and get the business to the point where operationally, and from a loss ratio perspective, is profitable. But we have not stopped investing in that business for growth in any way.

And so if I circle back to then how does the team feel, I think they feel fabulous. They're proud of the combined ratios they're running. Their combined -- they're proud of the fact that they're still growing in spite of lower marketing and the focus on profitability. So all in all, we are delighted with what we've set out to do in the last 3 or 4 years and where they are right now.

Thomas J. Wilson

Chairman & CEO

Yes. And I would say, we've built a strong team there. So some of the people are those that we acquired through Jonathan Adkinson, who runs it. He's been there for a long time, run it went well. The financial person has been there a long time. We've gotten in some new claims capabilities, cause as Don pointed out our new growth twice in size. You get twice as many claim people. Plus we have more Esurance eyes on Esurance cards as opposed to using third-party. So I feel like this is actually a really good time to consolidate our skills and capabilities to go to the next level of growth.

Operator

Our next question comes from the line of Michael Nannizzi from Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I just wanted to just touch on the expense ratio. Can you quantify, Tom, how much of the expense ratio increase was a reduction in -- or expense ratio decline was a reduction in advertising?

Thomas J. Wilson
Chairman & CEO

That's shows up in the Q. There's a table in the Q. You can get to the specific number. But Mike, I will tell you. I don't think -- we cut advertising, but we didn't -- we're not doing it in such a fashion that it hurts our long-term brand or market position. We just felt like we shouldn't continue to lean in and advertise and drive quotes when it [indiscernible] and underwriting standards.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. And then so certainly, I mean, the -- the expense ratio improved. The loss ratio is up. Year-over-year, it's up sequentially. I mean, did -- is that a lever that you feel like you can sort of continue to pull? Like is this a manageable level of expenses for the enterprise to run at sort of in the near-term?

Thomas J. Wilson
Chairman & CEO

Well, Matt mentioned what we're working to do. I don't think -- it will probably go up some over the course of time. We're not trying to -- it's not like we're -- we really are focused on making sure we do everything possible to get our short-term goals without throwing out our long-term growth or long-term strategy. So whether that's technology, advertising, investing and expanding products, like homeowners at Esurance or expanding our Benefits business into Canada, we're pushing hard on all of those things. So I think you should expect to see us manage between those, but we always focus on cost, yes. Did we decide in this quarter because we take our outlooks seriously? And we said, let's just not spend the money if we don't need to. So we didn't.

Operator

Our next question comes from the line of Paul Newsome from Sandler O'Neill.

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

This is actually meant as a little bit of a softball question. Could you talk about just sort of how the trajectory of improvement would happen for the price increases over time given the accounting for insurance and the fact that you've got a mix of 6 and 1-month policies? I'm just wondering if maybe people -- at least some people out there may have gotten a little ahead of themselves in terms of how quickly the underlying combined ratio improves given sort of the efforts that you're doing, just sort of the natural lag.

Thomas J. Wilson

Chairman & CEO

Well, Paul, first, I always that, that question as possible [ph] . There's 2 lines to look at it. If you go back to past slides, there's a blue line and a red line. The blue line is the increase in the earned premiums. And of course, what that -- it starts with the rate increases, which we show on the bottom of that slide. Then it goes through to, what you actually write. There's usually a little bit of leakage between there because what happens is customers raise their deductibles, which actually improves. It still gives you the same impact as raise in prices. It just doesn't show up in the blue line. It shows up in the redline. And that the severities go down a little bit, but then you have it written, and then it takes a while to come through earned. You can track those 2 written and earned and do some analysis of that and actually determine how it burns through. You could also do the same thing in between a rate taken. And so you could build a model that would help you on that part. The trickier part of your question is what to do with the red line. And the red line is our cost, which is obviously frequency and severity, that bounces around, obviously, by quarter. So you have to kind of -- what we tend to do is smooth it with various portions of time. We look at it on latest quarter. We look at latest month. We look at it over 6 months, 12 months, and you'd have to look at the frequency and severity. I think it's unclear yet where, as Matt pointed out, let's just call it the top of frequency is. It's hard to tell, but what we do know is as long as it continues to go up, our blue line will continue to go up. If you look at -- so what we tend to do is look at the difference between those and what we're trying to do is have the earned premium go up faster than what we would -- the combination of frequency and severity to go up. And you can't see when those lines cross. And when they cross, that's when you get the automatic drop in the combined ratio. So I can't give you a specific quarter because I can't -- none of us really know what will happen with the red line. What we do know is as long as the red line is going up, so is our blue line. And our blue line should go up by more than the red line.

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

The -- and then separate question. I had personally cover a lot of regional insurers and they seem to be mostly independent agent-channel, personal line-type businesses there, they're similar, and they think to be frankly, having quite a bit of trouble with a lot of scale issues. Given that sort of environment, given what we've seen with frequency, any thoughts sort of longer term about your independent agent channel, whether or not it needs more scale or not?

Thomas J. Wilson
Chairman & CEO

Well it's a good question. First, I would start with the independent agency channel exists because there are some customers who don't really care which insurance company they have, don't necessarily have the highest level of trust in insurance companies and trust a local advisor to help them select between those companies and give them the right coverage because they don't want to do it themselves. So as long as those customers exist, the function and role of the independent agencies will continue to be important. That role, over the last 30 years, has gotten smaller. That used to be a bigger portion of the market, but it kind of kept -- it kind of leveled out at about 30% of the market or so. As technology has helped people do more self-serve and that kind of stuff, it could be under a little more pressure. But I think you will continually see people that don't want to do the work themselves and don't necessarily have a trusted brand in mind that they want to pick from.

As it relates to scale on the independent agency company that serviced their channel, scale does matter. It matters in more and more each year, whether that's on data, technology, ability to negotiate lower costs to people. So I think you will continue to see a reduction in the share of small carriers, really, in all 4 of the channels, which is why we're trying to be in all 4 of those so we can leverage our scale across all of those. That said, the -- it is a slow process because many of the companies you're talking about tend to be mutual companies, or about half of the businesses held by mutual companies, and they tend to have an extremely high level of capitalization and so they can wait a long time before they have to get out of the business.

Patrick Macellaro

And we'll take one last question, and that we'll wrap up.

Operator

Our final question then comes from the line of Ian Gutterman from Balyasny.

Ian Gutterman
Balyasny Asset Management L.P.

Matt, do you view the ISO fast-track data as a reasonable proxy for a the loss trends you're seeing?

Matthew E. Winter
President and President of Allstate Insurance Company

Reasonable proxy. I'll get in trouble no matter how I answer that. We look at fast-track data -- Ian, it's informative. I think it's directionally correct and I think it is -- it shows us -- it confirms for us what we're seeing in the marketplace, but like almost every third-party data source, and this is true for all the rate services that are out there, we look at those all the time and there are some data issues with them. There are some reporting issues from certain states. So I don't think that they're ever determinative, they're only good indicators.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. The reason I ask is, it -- the data seems to suggest that there's more of a geographic bias to what was going on than what you guys have suggested in the past few quarters. I was curious if you agree with that part of it? And has anything changed in what you've seen in over the last quarter that suggest that maybe that this isn't as uniform as you thought in the past, that maybe it is a little bit more in certain pockets, like California and some other areas?

Matthew E. Winter
President and President of Allstate Insurance Company

Yes. So Ian, I don't think I ever said it was uniform. I said it was countrywide, but it varied by geography. And yes, I do agree with that. I think as the Dowling report, the IBNR weekly from the middle of October, talked about the geographic differences explaining much the discrepancy and frequency trends across underwriters, I think we do see that. We certainly see pockets. And Tom referred to it on this call already of pockets of geographies where the frequency trends are hitting harder than others. I referred to it on my last call, too. Miles driven is not uniform across the country. And when you look at the Department of Transportation reports, there are geographic differences of the miles driven. Northeast actually not up so much. Other areas of the country, up significantly more. So yes, I do think geographic differences explain some of it. We see geographic differences. When I say it's countrywide, what I'm referring to, it is widespread. It's not as if this is a localized issue where we did something wrong or we failed to implement a rating plan properly in a state. It -- that's why I referred to the countrywide impact. It's -- it is everywhere, but it is at different levels in each geography.

Ian Gutterman
Balyasny Asset Management L.P.

Okay, I got that.

Thomas J. Wilson
Chairman & CEO

In a sense to what we're seeing, you see the one movie which is the movie we report, which has countrywide numbers. We have 50, 100, 200 movies we are watching and we adjust for each of those movies. So whether it's a particular state, a particular risk class or a particular product line. So we're always adjusting. And that's the way our process and business model works.

Thank you, all, for your questions and insights. I'll try to keep you -- be respectful of your time. We -- just know, we continue to balance both the short-term and long-term initiatives. So we're creating shareholder value in driving our long-term growth. So thank you, all, and we'll talk to you next quarter.

Operator

Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.