S&P Capital IQ

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The Allstate Corporation NYSE:ALL

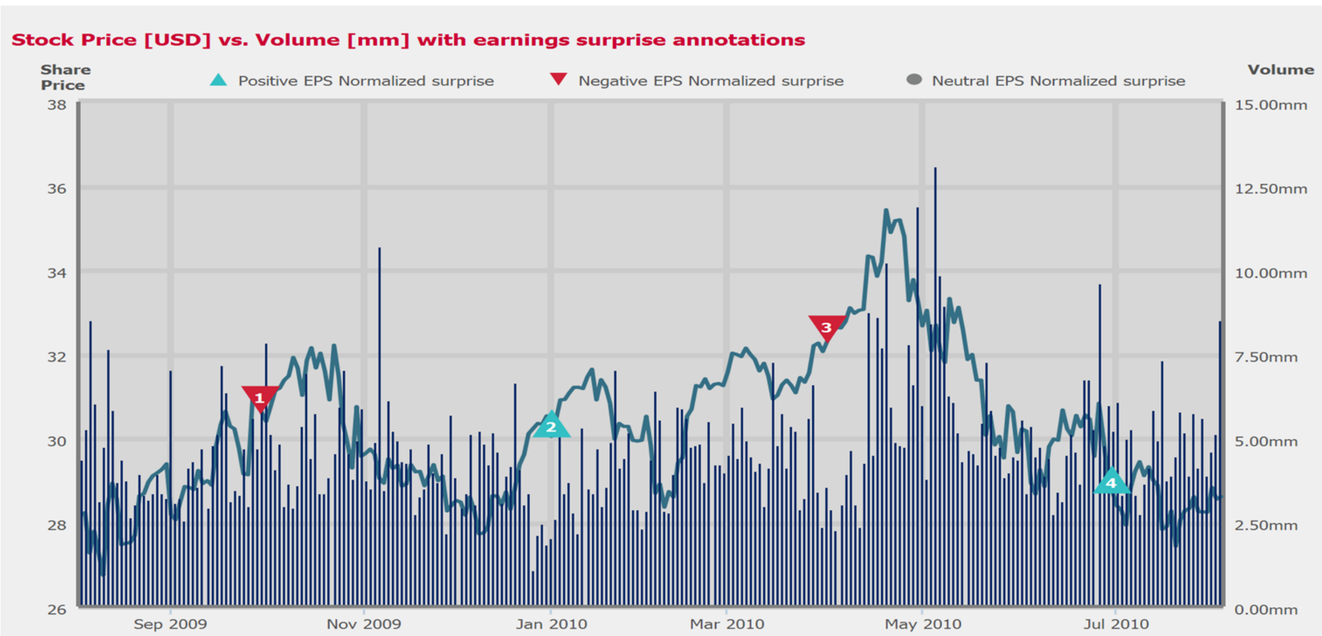
FQ3 2010 Earnings Call Transcripts

Thursday, October 28, 2010 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2010-			-FQ4 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.96	0.83	(13.54 %)	1.07	3.44	4.05
Revenue (mm)	6610.85	6499.00	(1.69 %)	6521.95	26829.42	26928.29

Currency: USD
Consensus as of Oct-28-2010 1:42 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2009	1.01	0.99	(1.98 %)
FQ4 2009	1.01	1.09	7.92 %
FQ1 2010	0.88	0.69	(21.59 %)
FQ2 2010	0.72	0.81	12.50 %

Call Participants

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Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Allstate Corporation Third Quarter 2010 Earnings Conference Call. [Operator Instructions] I would now like to turn the conference over to your host, Mr. Robert Block, Vice President, Investor Relations. Sir, you may begin.

Robert Block

Thanks, Matt. Good morning, everyone, and thanks for joining us today for Allstate's Third Quarter Earnings Conference Call. This morning, Tom Wilson, Don Civgin and I will give some commentary on the results then we'll open it up for your questions. Joining us for the Q&A are Judy Greffin, our Chief Investment Officer; Joe Lacher, President of Allstate Protection; Sam Pilch, Controller; and Matt Winter, President of Allstate Financial.

During the Q&A session, we ask you that you limit yourself to one question and a follow-up so that we can hear from as many of you as time allows. As is our practice, yesterday we provided our earnings press release, investor supplement and filed our 10-Q for the third quarter of 2010. We also posted a presentation that we will be using on today's call. All of these documents can be found in our website.

As noted on Slide 1 of the presentation, this discussion may contain forward-looking statements regarding Allstate's operations and actual results may differ materially. So refer to our Form 10-K for 2009, Form 10-Q for the third quarter and our most recent press release for information on potential risks.

Also, this discussion may contain some non-GAAP measures for which there are reconciliations in our press release and on our website. This call is being recorded and replay will be available shortly following the completion of the call. Christine Ieuter and I are always available to answer any additional questions you may have after this call ends.

Now I'll turn it over to Tom Wilson for his perspective on the quarter.

Thomas J. Wilson
Chairman & CEO

Well, good morning. Thank you for investing your time to hear about Allstate and the progress we're making to deliver value for shareholders. I'm going to start with a quick overview of our results for the quarter then Bob will go through each business unit and Don will cover our investment performance and balance sheet and capital positions. Then we'll open it up for your questions.

In the third quarter, we were again successful in executing strategy that creates shareholder value despite the weak economy. So why don't we begin, go to Slide 2. In total, we generated $367 million net income on $7.9 billion of revenue. There was an increase in net income of $146 million, that was primarily due to less realized capital losses this quarter than in Q3 2009.

Operating income was $452 million or $0.83 per share which was $86 million below the same quarter last year. And that's the result of lower operating income from Allstate Protection, our Property Liability segment. Property Liability had an underlying combined ratio of 89.2 for the quarter, bringing the full year for the nine months up to 88.8. That's squarely in the middle of our annual outlook of 88 to 90 that we provided in February. We did experience an increase in the third quarter, but remained comfortable with loss trends.

Growing Allstate Protection is critical to our success while we are able to largely maintain revenues from prior year levels we need to generate more unit growth. Standard all policies in force declined from $17.8 million last year to $17.5 million this year as strong growth in new business in most of the country was offset by declines in several large states where we've taken action to improve profitability. These actions also had a negative impact on improving customer loyalty in the quarter. Since our major competitors also had declines in customer loyalty this quarter, it was really a missed opportunity for us to improve our relative position.

Efforts to improve returns in homeowners and in Encompass Independent Agency business also had negative impact on growth. New business growth was a result of several things: it was up 2.4%, increased advertising, the successful addition of the Mayhem campaign to our marketing programs and targeted pricing actions to improve our auto competitive position.

Homeowners profitability remains a concern although progress is being made as our rate actions work into the numbers. Catastrophe loss at this quarter were low relative to other third quarters, but we had no major hurricane losses. The amount of none model cat losses remained at high levels. We continue to see price and tightened underwriting standards while we deployed better risk management tools in order to generate acceptable returns.

Allstate Financial continues to generate, to strategically position its business while raising returns. Operating income of $108 million was below the last few quarters due to several positive onetime items earlier in the year. Premium deposit volume was down as expected as we ship from spread-based businesses to more quality and BBB [ph] products. Allstate Financial did grow both the work side and Allstate Agency businesses were premiums and processes on underwritten products were up 33% and 2%, respectively compared to Q3 of 2009.

Allstate Financial also completed its focus to win cost reduction efforts. Investments had another great quarter from a total return perspective as the portfolio continues to generate substantial cash and improve in value. The net unrealized gain on the portfolio rose to $2.7 billion. This gain reflects lower interest rates and improved valuation on structured securities. While lower interest rates do translate into higher valuations, it puts pressure on operating income. We've continued to reduce our municipal bonds and real estate holdings, which also puts downward pressure on operating income. Don will cover the impact on that in a few minutes.

The net result of this operating performance was to raise book value per share to 35.48, that's up 6.7% over the last three months and is almost 10% higher than a year ago.

And now let's have Bob go through the results in greater detail.

Robert Block

Turning to Slide 3. Here are the Property-Liability premium and underwriting income results. In the third quarter, we produced the net premium written of almost $6.8 million, which was a slight decline from Q3 2009.

Total net written premium for the Allstate brand increased slightly, but was more than offset by a decline in our Encompass brand. Within the Allstate brand, our Standard Auto net written premium fell by 0.5%, small increases in the first two quarters of the year. Increases in new issued applications of 2.5% and average premium of 1.4% both compared to prior year's quarter, were more than offset by a decline in retention resulting in the premium shortfall. Total units also fell 0.3% sequentially and 1.7% from 3rd quarter 2009.

Homeowner net written premium increased quarter-over-quarter by 2.4%. Increases in average premium driven by approved rate increases in retention were more than enough to offset the 4% decline in total units. The recorded combined ratio for the third quarter was 95.9%, 1.2 points higher than the third quarter 2009. The underlying combined ratio which excludes the effects of catastrophe losses in prior-year reserve re-estimates was 89.2, right in the middle of our annual outlook range we provided at the start of the year.

Catastrophe losses for the quarter were for $386 million on a recorded basis. This result was made up of $371 million of current quarter losses in 29 events, $57 million of additional losses from events occurring early in the year, primarily second quarter hailstorms and a $42 million reduction of prior-year reserves. While the catastrophe loss was much less than the first two quarters, it was still relatively high for a third quarter given the absence of a major hurricane loss.

A few words on prior-year reserve re-estimates. Besides the $42 million reduction in catastrophe loss re-estimates, the third quarter included a $22 million increase for discontinued lines primarily for environmental reserves as we completed our annual reserve study for the discontinued lines and coverages. It also includes a $70 million litigation accrual charge to homeowners.

On Slide 4, we provide a look at auto loss cost trends, which in total remained within our expectations. On the left-hand side of the exhibit we provide the quarterly frequency results for bodily injury and property damage. In both cases, the level of frequency is elevated relative to the previous five years. In the upper right-hand corner, we displayed the paid severity change over time. Here, the results remain very good with only slight increase in the quarter. When these results are combined with those of the remaining coverages in auto loss result as a combined ratio that is fairly flat for the quarter compared to the third quarter of 2009.

On Slide 5, we show similar loss information for homeowners. On the top half of the exhibit, you can see the frequency excluding catastrophe losses was 2.3% less than the third quarter 2009 results. The paid severity excluding catastrophe losses increased 2.1% compared to the third quarter of 2009. With the increase in average earned premium for rate increases working into the results, the underlying loss ratio, which excludes catastrophe losses and prior-year reserve re-estimates improved again this quarter. We continue to execute under profit improvement actions designed to get homeowners to an acceptable level of profitability.

Shifting to Allstate Financial. Slide 6 displays the top and bottom line results for the last two years by quarter. The trends continue to reflect positive momentum in our efforts to produce higher returns, shift our focus to underwritten products versus spread-based products and serve our customers through Allstate Agencies and the Allstate Workplace Division. Premium and deposits on underwritten products increased 8.6% compared to the third quarter of 2009, while annuities declined consistent with our strategic direction.

Operating income for the quarter was $108 million or $13 million more than the third quarter of 2009, I would describe this quarter's result as relatively clean in terms of a one off items. When we adjust the first two quarters of 2010 for these kinds of items, the operating income drops back to a range of $110 million to $115 million for those quarters. The benefit spread was slightly lower due to higher but typical immediate annuity benefits this quarter compared to the third quarter 2009, which had favorable results for that product. The investment spread increased to $127 million reflecting decreased interest credited to contract holder fund, partly offset by a lower net investment income.

Operating costs were slightly elevated this quarter due to higher marketing cost and certain acquisition-related expenses associated with growth and the workplace division premium. The expense reduction actions associated with the focus to win program initiated in 2009 are now substantially complete in the program has met our target. For the quarter, Allstate Financial recorded net income of $85 million versus a net loss of $38 million last year. Realized capital losses were significantly lower this quarter compared to the third quarter of 2009.

At this point, I'll turn it over to Don.

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Thanks, Bob. I'm going to cover our investment performance for the quarter and the status of our capital position at the end of September. As you can see on Slide 7, the value of our investment portfolio increased to $102.2 billion in the third quarter. Largely reflecting the benefit of the decline in interest rates during the quarter. We continue to be proactive in risk management activities. And again this quarter, we reduced exposures in our municipal bond and commercial real estate portfolios while also protecting against an increasing rate environment. We reduced municipal bonds by $2.4 billion of amortized costs in Q3. The reductions targeted specific sectors and higher risk geographies.

Commercial real estate reductions totaled $484 million of amortized cost, and this was accomplished through a combination of maturities and prepayments with some offset due to refinancing activity. The total portfolio maintained a defensive position against interest rate increases. Reinvestment proceeds were placed in shorter duration instruments with derivatives being used to further manage the overall duration.

That said, the continuation of lower rates and combination with our risk mitigation and duration management continues to adversely affect investment income. On Slide 8, you can see that net investment income fell to $1.0 billion, a 4.2% sequential drop and a 7.3% decline from Q3 2009. Property liability investment income dropped 8.4% sequentially and 12.9% from Q3 2009 on reinvestment of the proceeds from our risk mitigation, rate management and investing activities and lower yielding and shorter duration securities, as well as the timing of equity dividends.

Allstate Financial investment income dropped 2.2% sequentially and 5% from Q3 2009, primarily the result of a drop in average portfolio balances. Our return optimization program included purchasing high yield corporate and asset-backed securities which have only partially offset the significant decline in interest rates. We continue to focus our investing activity to optimize both risk and return opportunities.

Net realized capital gains and losses shown on the bottom of the slide improved this quarter. We posted a pretax loss of $144 million compared to a loss of $519 million in Q3 2009. Other than temporary impairments, we're $167 million in the third quarter, less than half the amount experienced in Q3 2009. And they were concentrated primarily in the RMBS and CMBS portfolios.

Trading activity and risk mitigation actions drove net realized capital gains from sales of $319 million in the quarter, $118 million more than last year's third quarter. Most of the gains came from the fixed income portfolio, in particular public corporates, municipal bonds and agency paper. Equities contributed about a third of the gain. The derivatives loss for this quarter at $285 million was slightly better than the loss in Q2 2010, and $76 million better than Q3 2009.

We added additional breakout on this page to show our derivative experience by key risks. Our interest rate hedges produced a loss of $181 million this quarter, $100 million less than Q2 2010 and $219 million less than last year. These losses reflected the continued cost of protecting our portfolio from rising interest rates. Our equity had just lost $115 million as equity rallied about the same as last year's Q3. All this detail can be found in our 10-Q filing.

On Slide 9, you can see that our unrealized net capital gain position improved by $2.3 billion on a pretax basis from Q2 2010. And is $5 billion better than Q3 2009. After tax and DAC withstand at $1.3 billion, $964 million better than Q2 2010. Virtually every asset class participated in this improvement as we benefited this quarter from the declining interest rates and higher equity markets. The improvement in the portfolio valuation more than offset the cost of our risk mitigation programs.

While our net unrealized gain position is clearly a substantial improvement from levels over the past two years in terms of our book value, the current low rate environment that creates this unrealized gain is also the reason we've been actively working to reduce exposure increases and rates.

Finally on Slide 10, we provide you with a look at our capital position on both a GAAP and stat basis. Our overall GAAP equity climbed to $19.3 billion in the third quarter, a little more than 15% increase since year-end. Our current estimates of statutory surplus for Allstate Insurance Company and Allstate Life Insurance Company showed stable increase in capital levels in these companies. During the third quarter, the holding company received a $400 million dividend from AIC bringing the total for the year to $600 million.

With that, I'll turn it back to Tom.

Thomas J. Wilson
Chairman & CEO

Before I move to your questions, let me summarize the quarter really with six items. One was disappointing, one was mix and four where we had strong performance. Let me start with the disappointing. Our auto retention was down as we started managing profits in a couple of big states that offset the benefits from more marketing and the result was that items in our force in our Standard Auto business did not grow this quarter. That's the disappointing part.

The mix. The homeowners is making progress although we still have a high level of Cats. In the good category, our property liability combined ratio was in the middle of the range that we gave to you in February for both the quarter and the nine months. And this is our auto combined ratio has been in the positive zone that's below 100 for over a decade.

Investment results. We have great investment results. Risk mitigation is making a lot of progress on that and our return optimization, obviously, we stayed in the right stuff as we had a good increase in the value of our portfolio. Allstate Financial is focused to win program is done and it's got a balanced approach of raising returns and book value is up 7% for the quarter and 15% for the year.

So that's a summary of the quarter. Let's turn to your questions.

Robert Block
Okay, Matt, do you want to start the question-and-answer session?

Question and Answer

Operator

[Operator Instructions] Our first question is from Matthew Heimermann from JPMorgan.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

A couple of questions, first just with respect to the policies in force and retention, could you give a little bit more color maybe on those dates? If not specifically maybe generally that are affecting the retention. And also just we'd continue to be curious how much of the PIF decline you're seeing is also tied to -- would also be a customer that potentially is leaving because of the homeowners underwriting actions? The second question I had was just on that SG&A, was curious if whether or not there was a pickup in ad spend just because it's the fall and how's the balls picking up and based off by adds, et cetera. And then the last one quickly was just -- there's obviously, it's in the press that Bank of America is potentially looking to sell Balboa, you've been mentioned, I don't know if that's realistic or not. But I'd be curious as to what the strategic rationale would be for that given that it's predominantly property?

Thomas J. Wilson
Chairman & CEO

I can deal with the last one easier and then I'll get Joe to take on the states. The question on states, retention, what's happening with homeowners both as we improve profitability and as we seek to increase cross line sales. On the BofA Balboa, we obviously don't comment on acquisitions and if we were to buy it, we would have a strategic rationale for it given that property is not a high focus area for us in terms of growth right now. I wouldn't put that at the top of anybody's list. In terms of adds, where doing quite well there. Not only is it just been fall football season, we've increased our standard to be more competitive as GEICO and Progressive increased their spends. And Joe, do you want to take the retention and growth?

Joseph P. Lacher
Former President of Allstate Protection - Allstate Insurance Company

From a retention and growth perspective, Matt, we've talked a couple of times in the last couple of quarters about some specific states where we've targeting profitability focuses and I think we can give you a little bit of an outline of it in the Q. We've seen some issues in the states. We've pushed prices up a little bit some underwriting actions. We see some of that rippling through new business in Florida and California. We see some of that rippling through retention in California and a couple of other states. It's driven again by trying to get our selection mix from underwriting perspective in the right spot and getting our pricing where we want it to be. From a homeowners perspective, there is some impact, but not a big impact on the homeowners actions that we're taking. We have talked before about a preferred package discount that we used from a pricing perspective that makes it more attractive to have your auto and home with us, and that helps mitigate some of that issue.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

It sounded like even though we've talked about some of these actions that -- in your comments, at least, it sounded like maybe it was a little soft relative to what you had hoped that it would have been. So I guess, if that one is not true and if it is, I guess what types of accounts or I guess is it just a general across-the-board issue where it maybe slipped a little more or is there some more specific kind of type of customer?

Joseph P. Lacher
Former President of Allstate Protection - Allstate Insurance Company

I'm trying to hone in on the part of a follow-up question, if you're reading that it's below our expectation from comments this quarter, I'm not sure that's exactly where I'd say it is. We're seeing a little more of a retention impact than we've seen in prior quarters and we're seeing consistent trends on new business with what we've seen in the past. And it's not a huge change in the retention impact, it's a little bit.

Thomas J. Wilson
Chairman & CEO

Matt, let me just add one thing to do that which is, we believe in talking about results in total. We'll be happy to give you the components of it to make sure you know we understand and you can have a better understanding. On new business while it's up 2%, there are many states where it's up double digits. So we think our marketing programs are working back to adds program. We'll give you the number in total.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

That's fair. And I guess I would also argue that margins are important too.

Thomas J. Wilson
Chairman & CEO

Thank you. We think so.

Joseph P. Lacher
Former President of Allstate Protection - Allstate Insurance Company

We agree with you.

Operator

Our next question is from Bob Glasspiegel from Langen McAlleney.

Robert Glasspiegel
Langen McAlenney

I guess, if I could follow-up the Balboa question. You're up to $3.5 billion of cash at the holding company. Does acquisition and corporate development factor in to where you would stand on initiating the buyback program?

Thomas J. Wilson
Chairman & CEO

Well, I don't know where this Balboa drum beat is coming from, but it wouldn't be from us. Let me start with capital, Bob, because we are probably talking about it. We obviously have been doing good job of building capital whether that's a statutory capital or book value from a GAAP basis. We feel good about that. As we've said, the first thing we use with capital make sure our business is sound and stable and in a good position. And given the economy and investment markets over the last year and a half, we've done everything to keep ourselves in the right position and fully capitalized. Second then, we obviously tried to deploy that in growth of the business. The easiest place to do that would be to do it or the most opportunity in place would be do it by growing our business organically and we'd love to do that. We've also said that if there are acquisitions that we think fit we'll do those. You've seen what we've done over time on acquisitions. We're not in the market all the time buying all kinds of stuff. We do try to buy stuff we think will grow us. So the Workplace business was number three when we bought it, it's number two now and we're liking its trend. So we tried to be smart about what we buy. And obviously then we return it to the shareholders we've talked before about our dividend policy, which I have my board look at every quarter. We do that based on sort of a percentage of earnings and I think you should expect this continuing set dividend policy based on the amount of money we make. And if we have capital above that, then we've also bought back stock. We've not announced the stock buyback program today and not about to because I feeling we're in pretty good shape. But if you could look at our track record, I'm returning capital to shareholders, it's been great. So I think you should expect that same philosophy to apply going forward.

Robert Ray Glasspiegel

Janney Montgomery Scott LLC, Research Division

Your stat capital went up I guess $600 million if we add back the dividends which was at least a bit more than your GAAP income this quarter. What were the key drivers or the difference between Stand and GAAP?

Thomas J. Wilson
Chairman & CEO

Are you talking about, which entity?

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

The insurance companies.

Thomas J. Wilson
Chairman & CEO

The insurance company had an improvement in the unrealized position as well.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Net through the stat capital and the unrealized?

Thomas J. Wilson
Chairman & CEO

Yes. Remember we picked up the improvement in equity at AIC.

Operator

Our next question is from Keith Walsh from Citi.

Keith F. Walsh
Citigroup Inc, Research Division

I guess first for Joe. I saw the press release a few weeks back about the Idaho service center and I just want to know if this is more indicative of a maybe more aggressive push in the Direct market? Maybe you could put a little color on that and why you're opening that up? And maybe you should update us on Direct and that kind of follow up.

Thomas J. Wilson
Chairman & CEO

Let me maybe talk first about that call center. We obviously opened a call center in San Antonio, we opened one in Idaho just recently. That's in part because not only do we do Direct business, but we handle all kinds of the service related work on behalf of our agencies because people want to be there 24 by 7. And we've had an opportunity we could open those anywhere in the world. We've been seeking opening them in the United States at this point because we think it's the right thing to do. When you look at our customers they say they will think higher of our company that are better of a company that puts jobs in the U.S. even if it cost a little more money. Now of course everybody wants a good price, so we have to make sure we continue to use the right kind of labor around the world which we've been very active in. Joe, maybe you want to make a comment about the growth of Direct and how it fits in.

Joseph P. Lacher
Former President of Allstate Protection - Allstate Insurance Company

Yes. And a lack of the same things. We use all our service center capabilities to service multiple channels. So this is not purely related to Direct. We are growing our Direct business. Our enthusiastic about those prospects and continue to do so. I think we can give you a little bit of information in the Q. As you can see that business was growing north of 15% for us in the quarter. And we feel good about it and we'll continue to keep our marketing and our operational capabilities lined up to facilitate doing that more so. We want to service customers in the way they want to be serviced, to meet their needs and the value proposition that resonate with them. And that will continue to be a focus for us as long as it is for the customers.

Thomas J. Wilson
Chairman & CEO

Keith, this is Tom. I want to reiterate underlying and expand on the balance, something that Joe said. The key thing is to look at the customer segment and say what is it they want and make sure you're delivering it. So there's a whole bunch of customers who want a personal touch from somebody, want a relationship and we obviously seek and do that quite well with our agencies here. There are other people who are self-directed and wanted to direct, so we try to deal with customers as to how they want it. A lot of times people get focused on distribution without focusing on the customer. We think you got to focus on the customer first and then figure out what distribution works for them.

Keith F. Walsh
Citigroup Inc, Research Division

And then come my second question just more broadly, the inconsistency in the result is clearly an outlier to your peers. Can you help us understand why that is because I'm just having a hard time with that.

Thomas J. Wilson
Chairman & CEO

Maybe you could give me a little clarification on inconsistency.

Keith F. Walsh
Citigroup Inc, Research Division

All consistency. You've got weather-related losses this quarter, I didn't see that out of the TRB or PGR. The PIF numbers are clearly up and down sequentially when we look at it, the overall earnings results just pretty inconsistent across the board. So we can go on and on offline if you want, but maybe we can start there.

Thomas J. Wilson
Chairman & CEO

What I can tell you is that we give you a combined ratio for the year that's ex-Cats and prior reserve issues which of course are impossible to forecast. And we've been dead in the middle of that for as long as we've been doing. So I feel good about 89.2. As it relates to catastrophe losses, when you are as broad as we are and across the country, you're subject to all of those. So some of the companies you mentioned have a more narrower focus in terms of where their homeowners businesses is.

Operator

Our next question is from Alison Jacobowitz from Bank of America.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I was wondering if you could talk a little bit about the currency in Auto this quarter, sequentially seems to spike up a little bit with 7% in a couple of areas. And also if it's possible could you give us some color on the growth? I know that several states are holding you back, can you clarify a little bit as best as you can where you are in that process or where you think you are? And when that pressure might start to ease up?

Thomas J. Wilson
Chairman & CEO

Joe why don't you take both of those?

Joseph P. Lacher
Former President of Allstate Protection - Allstate Insurance Company

Relative to the frequency, Alison, we are seeing a bit of an uptick in frequency. We continue to look at it. Generally, the spread across the broad set of geographies, across a broad set of customer, vintages, if you will, tenure that we have with customers and across most ways that we can look at it. We are seeing a little bit of that spike being an increase in claims that are closed without payments, which might be a little bit of a tail impact on some of what we have see in prior periods. We made a big shift in our claims systems over the past couple of years which is done basically, but it does impact some of the prior period claim practices. So a little bit of that frequency, we think might be some noise out of. But even if you take the noise out there is a bit of an uptick. We've seen some increases in gas purchases and miles driven which we -- some correlation to that. I'm not sure where to point we declared a long-term trend but we're watching them. Relative to the growth question, we don't give forward-looking growth guidance or production guidance. What I will tell you is that we're focused on over the long term grow in our business. We are focused on preserving a strong track record of having very powerful margins and we'll keep those two items in mind as we march forward and I think the comments we've given you is that we've got new business up, double digit in states other than California and Florida where we've seen new business decline year-over-year. We focused on some specific profitability actions in those geographies and that will work its way through the system, at least the new business relativity year-over-year. We've been talking about this for three quarter, so you don't have year-over-year problem in another quarter or quarter and a half. That's just algebra. But in terms of where we project it going forward, I'm going to avoid doing that.

Operator

Our next question is from Paul Newsome from Sandler O'Neill.

Paul Newsome
Sandler O’Neill + Partners, L.P.

I apologize if I missed this, but the little litigation charge that was in home insurance, what was that? And maybe you could talk about the A&E [ph] charge as well?

Thomas J. Wilson
Chairman & CEO

Paul, this is Tom. I'll give you a quick uptake on the lawsuit and Don, maybe you want to take any A&E [ph]. As it relates to the loss suit, it was a potential class action suit filed in a state court. You remember that they changed -- there's class action fairness act which removed class actions from State courts to Federal courts because we thought that, we know that Federal courts deal with them in a more balanced approach. This is one's we have left that was from a State court. It was down in Texarkana, Arkansas. It was related to the way in which we calculate the amount paid to fix homeowners claims. A number of other carriers that were forced down in that court had settled claims, had settled their amounts at what we think are amounts higher than that that's actual was cover 48 states because we've won this issues in many other states. It's just in this particular state court, we felt it was better to settle and move on.

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

And on the A&E, Paul, we do an annual analysis of those reserves and we, as in previous years, we did it this year and added about $18 million.

Paul Newsome
Sandler O’Neill + Partners, L.P.

Any reason for that?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

No particular reason, no. No specific reason.

Thomas J. Wilson
Chairman & CEO

I mean it's not like we've got some big claim out there or something we're worried about it. As you remember in the environmental thing, I think about 65%, 70% of it is incurred being but not reported. So of the amount we have up for environmental, we don't actually have specific claims but you look at the trends and what comes in and what you have to pay out and you make changes. In this day and age, you put up when you see it.

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

If you could focus on the Encompass brand and the efforts that -- a little bit more on the efforts you are trying to make that more profitable and maybe talk a little bit about sort of the long-term viability of that operation. It has been I believe certainly not less profitable than in the core business for as long as I can remember.

Thomas J. Wilson
Chairman & CEO

Paul, let me have Joe take that as to where it is. But let me just say from our standpoint. Remember we bought that business back in 1999. We've looked at it every which way to Sunday, and we've had a good return on that business because we bought it so cheap.

Joseph P. Lacher
Former President of Allstate Protection - Allstate Insurance Company

So when we look at it, Paul, I would encourage you to think about the Encompass business right now as having sort of two parts in it. There's a core target that has long been its target of a bundled auto and home targeting sort of a mass affluent customer base below the real high end that you see in some high-valued homeowners players. And we do well in that product. It's position well inside of agencies. They like the product, they like its performance. We fit into a well-defined niche there. And broadly, are happy with the performance on any given day, any given quarter. We might want to be a little bit better whether it's growth or profitability. Then there's the second part of the business. A couple of years ago, we tried to expand our targeting to produce more Auto business through that brand. We ended up adding groups of agencies that were more specialist in auto. Broaden the product capability to target that mono line auto and found that our approach both through a combination of distribution and a combination of how we price construction of the product and managed the underwriting wasn't effective in that marketplace. And it hurt us from a profitability perspective. What you're seeing right now running through the numbers is the impact of unwinding that latter part of a book of business. Now as we do that, it had a little bit of a ripple over effect into the core. So that's getting splashed with the cleanup, if you will. As we move through that, we will continue and are continuing to focus on the core niche where Encompass has been affected. I'm very confident that we can be effective in that space, grow that business, make reasonable returns on it and then it's something that's desired by independent agents as distributor and has a good customer proposition. We just have to finish the cleanup of that auto specialists strategy.

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

Is the split 50-50? How big is one versus the other?

Joseph P. Lacher
Former President of Allstate Protection - Allstate Insurance Company

It got as big as at one point as close to 50-50. I'm not going to decline to give you the specifics of exactly on where it is right now.

Operator

Our next question comes from Cliff Gallant from KBW.

Clifford Henry Gallant
Keefe, Bruyette, & Woods, Inc., Research Division

Two questions, one, the add spending, the elevated levels we saw in the quarter should we expect that going forward? And then two, during the quarter, State Farm had an announcement regarding drywall lawsuits and it look like they were trying to move towards some kind of settlement, and I was wondering if you had any update on that issue?

Thomas J. Wilson
Chairman & CEO

In terms of add spend, you've seen us increase it this quarter because we felt it was worthwhile to take the risk and see what kind of growth we get on it. As long as we keep getting growth out of it, we'll keep doing it. When we think it's not economic, then we won't to do it. As it relates to drywall, we don't really have anything to talk about other than what we've said publicly before which is we don't think there's exposure. If you're talking about Chinese drywall, we don't think there's exposure. We think that's a product liability issue, not a homeowner issue.

Operator

Our next question from Meyer Shields from Stifel, Nicolaus.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

I want to drill down a little bit into a comment that Joe made about wanting long-term growth in Allstate brands. I know if we look back about a year, a year plus the capital was really constrained and I think that translated into a focus on maximizing current underwriting profits probably at the expense of growth. If I understand you correctly, is that concern now evading so that you can focus more currently on growth?

Thomas J. Wilson
Chairman & CEO

That's right. Capital question, Meyer, let me take it. If you have a follow-up as to what you think what Joe was doing, we should go there as well. But as it relates to capital, you're correct in the assumption that we've -- I don't know that we felt capital was constrained, everyone's got their own word around that. But we weren't comfortable with the economic or investment outlook really starting in 2008. So at that point we chose to protect margins at the expense of growth. You are seeing the consequences of that both in '09 and '10 as we try to work through that because this has a long trends in it and you can't sort of because so much of our business is renewal. It's hard to kind of turn that thing on a dime. But you are correct in sort of what you see today. Do you have anything more specific on the growth that you want Joe to answer?

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

I think so. In the past, you've given ratios of competitor rate increases, decreases in auto and how you thought of playing it. And I'm wondering whether that's still trending positively?

Joseph P. Lacher
Former President of Allstate Protection - Allstate Insurance Company

Can you expand on it a little bit because I'm trying to make sure I understand how you're asking the question.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

I guess, what I'm wondering is whether your expectation for the next short term, call it 12 months is that your competitor profile will improve due to other companies rate increases?

Joseph P. Lacher
Former President of Allstate Protection - Allstate Insurance Company

That becomes a hard one for us to sit here in this environment and forecast for you. But what we're going to do from a pricing perspective and what other folks are going to do from a pricing perspective. I'd love it if they'd forecast it because we'd find that to be useful. But from a competitive perspective, I think that the conversation will be tough for us have here.

Operator

Our next question is from Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

I guess just quickly here on the underwriting expenses and the property casualty area up about 10% in the quarter, up 12% quarter last quarter. Is that the add spend coming through or is there anything else running through there?

Thomas J. Wilson
Chairman & CEO

Pension costs too.

Brian Robert Meredith
UBS Investment Bank, Research Division

How much of the pension costs addition?

Thomas J. Wilson
Chairman & CEO

I don't think we disclosed it but if you want to follow up with Bob, I'm sure he'd be happy to give it.

Brian Robert Meredith
UBS Investment Bank, Research Division

If I take a look at average written premium per policy, the year-over-year growth kind of de-accelerated in the quarter. Is that just a function of just getting more competitive out there from a rate perspective at Allstate or is there's something else that I'm missing?

Thomas J. Wilson
Chairman & CEO

If you look at the -- almost a follow-up to the prior conversation now we're looking through the back window as opposed to the forward one. Yes, we've talked about it before and we have been a little more focused on being more competitive sometimes. In some cases that's been taking the rates down. In other cases it's been not taking them up at the same rate we have before. And that's the bulk of what's driven through here.

Brian Robert Meredith
UBS Investment Bank, Research Division

You kind of made reference to the customer loyalty kind of being down a little bit in the quarter. Can you talk about initiatives right now that you got in place to try to keep that moving up or heading the other direction?

Thomas J. Wilson
Chairman & CEO

Brian, same things we've been doing which is, first it was down a little so you get into a -- I just think it was a missed opportunity because everybody else is down too. And we need to move it up because if we move it up retention will go up. If retention goes up, growth will go up. And that will be good for all of us. The programs we have in place just to refresh your memory, we changed the reward system so both our agencies and our employees benefit from higher customer loyalty. Agencies and that some of there bonuses paid on retention. Our employees and that the profit sharing plan we've switched it from profits to customer loyalty so people's 401(k) matches depending on getting up. So we have the reward side. On the accountability side, we continue to increase the accountability for results and if people don't take good care of our customers, they can't be part of our team. We also have a number of programs underway, underneath that to help us improve loyalty. Everything from calling people, doing protection reviews, calling them when they're bill is late to having better and clear communication. We've launch some sub called Insurance Made Simple. So there's a whole bunch of things that we do along the way which supports both accountability and recognition. One of the challenges we had this quarter was the benefit of all those programs, rewards, accountability and new initiatives did not offset the impact that reasonably large increases in price had in a couple of the big states. So as price goes up, obviously people get unhappy and you'd have to make them even more happy and we just didn't accomplish that. That said, we didn't make as much progress in the other part of the country as we need to. So it will stay a big focus for us.

Operator

Our next question is from Vinay Misquith from Credit Suisse.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

The first question is on the capital position. Stock capitalize has increased nearly $2 billion since the end of 2008 and you're GAAP capital has increased $8 billion. Just curious about whether the fact that you've not announced a buyback, has that been held back by the S&P negative outlook? And are you waiting for that to be removed before you make the announcement on that front?

Thomas J. Wilson
Chairman & CEO

Vinay, I'll make a quick comment and Don, you may want to make a comment as well. We are appreciative of the recognition that capital has gone up and we think it is a big thing and should be driving shareholder value more than it is. At the current book value multiples, we are in my estimation, a bargain. But as it relates to capital levels, we run it base on what we think, not what other people think. We set up capital, we look at economic capital and we think we have plenty of economic capital. S&P can have a negative outlook on that, sure, why given that we think that we have excess capital as to obviously you and another people on this call. So they're outlook is not keeping us back from doing anything. I don't need their approval to buy back shares or pay dividend or do anything else.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

So what is holding you back from buying back stock right now?

Thomas J. Wilson
Chairman & CEO

It's just where we started, which is all things at the right time.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

The follow-up question is in terms of the actions taken to improve profitability. I think it has a negative impact on retention in California, Georgia, New York and North Carolina and also in Florida. Can you give us a sense for what inning are we in terms of rate increases or in terms of these actions taken to improve profitability?

Thomas J. Wilson

Chairman & CEO

I think, Joe, answered that, which is we don't look forward. We increased prices when we think we need to. There's a number of trends that -- each of those states is different. You remember in California we had to take some big decreases I think in that 2008. And so we're not even back to where we were when we got started with this. In some of the bigger states that have a personal injury protection, you're seeing a number of industry things going on where fraud is way up in places like Florida and New York. So it's hard to predict what inning you're in. I can only tell you that our approach and what Joe and his team do is when they see a problem they go to fix it. And we try to keep balance, we try to keep rate increases small as opposed to large and infrequent and we'll continue to do the same thing in the future.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

And on the homeowner side, the trailing 12-month rate increases seem to be on a 6%, do you think that you would like to take a higher rate increase given that the combined ratio was 100% this quarter in homeowners?

Thomas J. Wilson
Chairman & CEO

I think consistent in saying we need a better return from that.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

And what's the timeline that you propose to decorate some of that line?

Thomas J. Wilson
Chairman & CEO

We don't give projections on what we're doing.

Joseph P. Lacher
Former President of Allstate Protection - Allstate Insurance Company

It is useful, Vinay, remember that the homeowners had the litigation settlement that run through that number this quarter. So that's a significant number.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Yes, that's full points in the combined ratio. And the combined ratio was 104.7 so when you take that all that's a 100%. This quarter I don't think was a really bad quarter in terms of tax, so I'm a little surprised that it was 100%. And so I was just wondering whether you're trying to take rates up say maybe 10% in that line to get it more to the high 80s, low 90s combined ratio?

Thomas J. Wilson
Chairman & CEO

Vinay, we've been very consistent in saying we need a lower combined ratio, higher return in homeowners. I think actually when I summarize the quarter I said that, that wasn't in my in the disappointing category, it was in my mixed category. Wasn't the four positive but we're not there yet. It isn't like you can just wave a magic wand and all of the sudden charge people a lot more money. Given the regulatory structure and the customer relationships we're trying to manage. So we try to do it in a balanced way. Joe talked earlier about the success we're having with giving larger discounts on auto insurance to monoline homeowner customers, that's worked quite well for us. So we want to do this in a way that accelerates the overall growth of the company in terms of the size of the company as well as improve the terms.

Operator

Our next question is from Greg Locraft from Morgan Stanley.

Gregory Locraft
Morgan Stanley, Research Division

Wanted to cover a couple of things, number one how are you feeling on the pension at this point in time? It was underfunded by over $1 billion at the end of last year?

Thomas J. Wilson
Chairman & CEO

We obviously have plenty of GAAP. First, how we're feeling, we feel good about the pension and that it's an obligation of the company. We put a lot more money into it this year and we obviously have plenty of capital to keep the pension whole. So it depends on what you mean about feel about the pension? We obviously would like returns to go up on that portfolio. And that we've had good return so far this year but we're like everybody else, we still suffer from the downturn in equity values that happened over really the last three or four years. Don you have any added comments you want to add?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

No.

Gregory Locraft
Morgan Stanley, Research Division

And just to figure refresh, how much will you put into the pension this year? And then how are you thinking about funding from a company-contribution perspective next year?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

You know what let us follow up on that, Greg, I just don't remember.

Thomas J. Wilson
Chairman & CEO

We find it when we need it. There's obviously a tax advantage to putting money in early and letting it role but then the downside to it is you lose a little bit investment that come with the company. You're talking about our contributions have usually been in the hundreds and millions of dollars, so I wouldn't. It's not a meaningful number in terms of the overall operating income of the company.

Gregory Locraft
Morgan Stanley, Research Division

Second, is the debt level of the company -- you guys have done a nice job deleveraging for several quarters now. How low do you think this could go? I think your target is low 20s and it seems like you guys are getting pretty darn close to that right now?

Thomas J. Wilson
Chairman & CEO

I guess if you do the math on GAAP, that's how it gets to deleveraging. If you do the math on economics, we've been right where we've always been. And on GAAP, it's $23.5 million so that feels about right. We obviously don't have a need for extra capital today, so we don't need to go and borrow. Don is always looking at how he wants to optimize our capital structure and well that's within the existing $6 billion of debt or whether he wants to move other things. You've seen us to do that over time. Everything from issue, preferreds to debt and tied to the overall capital of the company. But we don't have any plans. We're not announcing anything today as to what we're doing differently.

Gregory Locraft
Morgan Stanley, Research Division

I guess I was just wondering is that $23.5 million, I mean is there a governor below which you guys would I guess take out more debt in order to kind of hold the ratio flat. Or do you look at it more or less on -- you don't look at it as much in a GAAP basis is kind of what you're implying?

Thomas J. Wilson
Chairman & CEO

That's right.

Gregory Locraft
Morgan Stanley, Research Division

Last is on the investment income line, that was one of the ones that we were sort of surprised on. And I'm just wondering how do we think about modeling that going forward? How much is coming due or maturing? And what is the new reinvestment rate look like?

Thomas J. Wilson
Chairman & CEO

Judy is so happy she got a question because she's been sitting here patiently waiting for someone to jump on it. We thought maybe Don had just done such a good job of explaining to you, you didn't have any question. Judy?

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

So maturities are I believe disclosed on Page 8 of the note, so you can take a look there and see what we've got coming off over the next several years. With regard to income and there are many factors affecting investment income. First, we're in a low rate environment, rates are down, as everybody knows 100 to 150 basis points, 50 basis points in the quarter alone. We also have our proactive stance on risk mitigation and we've been doing that for a couple of years. We think it gives us a lot of flexibility in the portfolio, better positions us going forward. We've been focused largely on commercial real estate and municipal for the past year or so. And I'd say that those programs are largely complete.

We've also done some duration shortening or duration management within the portfolio. And this quarter in particular, we took a hard look at the cash duration in the property and casualty portfolio and made some moves to shortened the cash duration. Because we felt we were using a derivative to a great extent more than we needed to in that portfolio and decided to bring down the cash duration and that impacted income as well. And then just normal trading activity in this low rate environment also impacts investment income. When you look at how to manage it going forward, you talk to any portfolio manager that has fixed income in their portfolio, you've got a situation where rates are low, they could stay low for an extended period of time and then you're looking at less income as a portfolio manager. Rates could decline further which the volume of a portfolio would go up but you end up with earning less. And then if rates rise, the value of the portfolio could fall, would fall but either you have more income. And I guess the actions that we're taking put us in a position where we feel that we have the flexibility to be proactive in managing the portfolio and driving shareholder value.

Gregory Locraft
Morgan Stanley, Research Division

A follow-up on that is the increase in the expense line that goes into this, and this is just on the PNC side. Is that because of the unwind of derivatives? Or I didn't fully explain how the lack of using derivatives caused this number to step down so, so much?

Thomas J. Wilson
Chairman & CEO

What expense line are you talking about? Are you talking about underwriting expense or you talking about investment expense?

Gregory Locraft
Morgan Stanley, Research Division

I'm talking investment expense, it went up I think $3 million year-over-year which was a heck of a jump if you look at the last several quarters in the supplement?

Robert Block

This is Bob. Why don't you and I talk about that offline, and we can get behind those numbers.

Gregory Locraft
Morgan Stanley, Research Division

So the number you put up though is much more indicative of what the future run rate is going to be out of investment income and then we can model the maturities and reinvestment rate for your guidance?

Thomas J. Wilson
Chairman & CEO

You can model that. I would take up the guidance. As Judy said, what we're try to do is manage the total return in a environment that could go flat out, go up, go down and with shortened duration. We're staying on the balls of our feet so we can move quickly and harvesting gains. So we're not just writing it down and have the gains to go way of interest rates go up. We're trying to protect ourselves if they do.

Operator

Our next question is from Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Given the pace of frequency trends in Auto, I'm wondering if the rate actions you've taken prior are anticipating this frequency increases? Or where we stand in terms of your current rate outlook related to what frequency is doing?

Joseph P. Lacher
Former President of Allstate Protection - Allstate Insurance Company

I'd love to tell you that we can look forward, six or nine months and figure out what frequency is going to do but we don't. The actions we've taken in the past are functions of a what we thought was going on in maybe a very short-term view of where we think frequency might be headed. My comments before suggested that we're seeing some of these increases in the relatively recent periods. Parts of them when we look period-over-period, we think are a little bit attributable to the claim system changes we made over the past couple of years and parts of it appear to be more broad and environmental. And we're going to watch and see what's happening with those trends. See if in fact they are trends or a near-term anomaly and will factor that into our pricing approach, which will include all the things we talked about in terms of managing margins and thinking about how we run this business relative to the entire impact of the corporation.

Thomas J. Wilson
Chairman & CEO

Josh, its Tom. On a longer-term basis, I think for 20 years, real good 20 years, frequency came down as -- we got safer cars and better drunk driving laws, older drivers, more cars per household. The whole bunch of things drove that trend. And if you look over the shorter period of time, it looks much flatter. So that puts Joe's comments in perspective. 2010 looks like 2007.

Joshua David Shanker
Deutsche Bank AG, Research Division

Thinking then about the competitive nature of the market with the rate environment where it is. Coming into the new year, I'm sure you're doing some budgeting. Given the seasonality of shopping behavior, and I know you guys you have a new ad campaign out there that's running a lot, are you planning on increasing the budget for advertising for first quarter '11?

Thomas J. Wilson
Chairman & CEO

That would be a competitive piece of information we wouldn't want to give a out.

Operator

A follow-up question today is from Sarah DeWitt from Barclays Capital.

Sarah Dewitt
Barclay's Capital

I wanted to follow up about your appetite for M&A. Can you elaborate on this and talk about if you have any desire to expand internationally because there have been some reports about Allstate being interested in RBS's PNC business.

Thomas J. Wilson
Chairman & CEO

This is Tom. I'll come back to what has been our stock answer with that which isn't going to be very specific to what you asked, which is we look at everything that comes across the market. Sometimes we go on proactively look for stuff. We tend to be relatively conservative in the price we would pay and try to only buy things where we think we can add lots of value. So when we bought the Workplace division, a decade ago, we thought we could expand it geographically across the country, and we did that. We thought we could expand it to sales and Allstate Agencies, we did that. We thought we could expand from small companies to large companies and we did that. When we bought CNA as business had a combined ratio of 117, although Joe is not happy with its combined ratio at 100 it's been substantially below 100 since we've bought it and we've made good money on that. So that's kind of the approach we have. To answer your question about international versus domestic, much more interested in seizing the opportunity available in the domestic market than international. But if something was appropriately priced and we thought we could add value, we always look at it.

Thomas J. Wilson
Chairman & CEO

Thank you all for taking the time. Sticking with our space, we've been focused on the customer and it's driving all of our activity both with Joe and his team at Allstate Protection, with Matt and his team at Allstate Financial and they were being active in risk mitigation and return optimization with Judy and her team. So all that productivity has created more shareholder value, so book value again is up this quarter and we feel good about that. We're a great management team, we'll continue to work success to increase the value of your investment. Thank you, and we'll see you next quarter.

Operator
Ladies and gentlemen, thanks for participating in today's conference. This concludes the program. You may now disconnect. Good day.