S&P Global
Market Intelligence

The Allstate Corporation NYSE:ALL

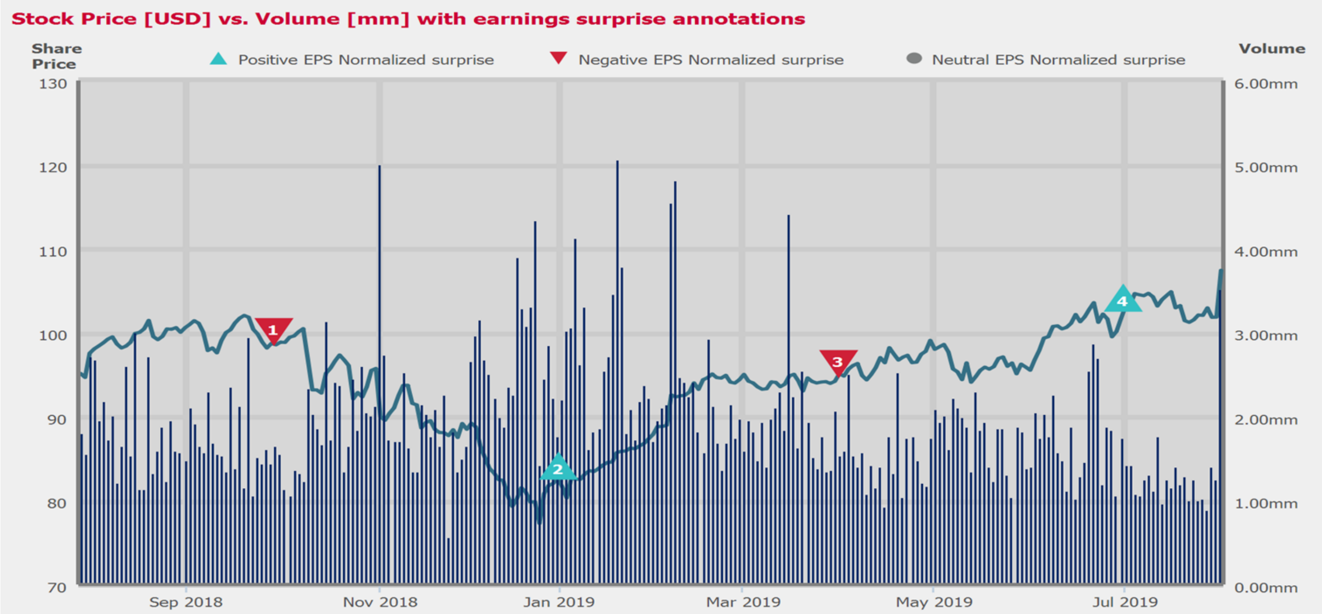
FQ2 2019 Earnings Call Transcripts

Wednesday, July 31, 2019 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2019-			-FQ3 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.55	2.18	40.65	2.41	9.37	9.98
Revenue (mm)	8963.00	8986.00	0.26	8953.00	34688.00	36608.67

Currency: USD
Consensus as of Jul-31-2019 11:21 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2018	2.25	1.93	(14.22 %)
FQ4 2018	1.16	1.24	6.90 %
FQ1 2019	2.32	2.30	(0.86 %)
FQ2 2019	1.55	2.18	40.65 %

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Call Participants

EXECUTIVES

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

John Griek
Director

John Edward Dugenske
President

Mario Rizzo
Executive VP & CFO

Mary Jane Bartolotta Fortin
President of Allstate Financial Businesses - Allstate Insurance Company

Steven Emil Shebik
Vice Chairman

Thomas Joseph Wilson
Chairman, President & CEO

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Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

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Michael David Zaremski
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Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Allstate Second Quarter 2019 Earnings Conference Call. [Operator Instructions] As a reminder, today's program is being recorded.

And now I'd like to introduce your host for today's program, Mr. John Griek, Head of the Investor Relations. Please go ahead, sir.

John Griek
Director

Well, thank you, Jonathan. Good morning, and welcome everyone to Allstate's Second Quarter 2019 Earnings Conference Call. After prepared remarks, we will have a question-and-answer session.

Yesterday, following the close of the market, we issued our news release and investor supplement, filed our 10-Q and posted today's presentation, along with our reinsurance update on our website at allstateinvestors.com. Our management team is here to provide perspective on these results and cover a special topic. Mary Jane Fortin, President of Allstate Financial businesses, will provide an overview of Allstate Annuities and how the business has been substantially reduced in size over the last 13 years, and how we have managed the remaining liabilities to maximize shareholder value. The special topic last quarter was about how we match capital to risk at a granular level to ensure we maximize economic returns. Our first special topic at the beginning of this year was how telematics is being utilized in auto insurance and how Arity, our telematics business, is a leading innovator.

As noted on the first slide of the presentation, our discussion will contain non-GAAP measures, for which there are reconciliations in the news release and investor supplement and forward-looking statements about Allstate's operations. Allstate's results may differ materially from these statements, so please refer to our 10-K for 2018 and other public documents for information on potential risks.

And now I'll turn it over to Tom.

Thomas Joseph Wilson
Chairman, President & CEO

Well, good morning, and thank you for joining us to stay current on Allstate. Let's begin on Slide 2. Allstate's strategy to protect people from life's uncertainties, the strategic objectives are to grow personal Property-Liability market share and expand other protection businesses. So we start with the upper oval. The personal Property-Liability market provides consumers protection by ensuring a wide range of assets: automobiles, homes, motorcycles, boats, other personal assets and then their personal liability. We use highly recognized brands, sophisticated pricing, differentiated products, claim expertise and telematics to deliver unique customer value propositions. We're also building an Integrated Digital Enterprise that will lower cost and better serve customers.

As shown in the bottom oval, this strategy also includes providing consumers protection plans, life insurance, volunteer workplace benefit and identity protection. We also have a rapidly growing share economy in commercial insurance business that serves ride-sharing companies and our telematics provider, Arity. These businesses are enhanced by leveraging our brands, customer base, investment expertise, distribution, claims capabilities and capital, and it's not just what you see in the oval that's real. So for example, we're re-branding SquareTrade products in the United States to fully utilize the Allstate name, which both leverages and expands our reach since these products are sold through major retailers.

Our claims capabilities are helping us significantly grow the commercial insurance business with the ride-sharing companies. Collectively, the protection businesses in the bottom oval have a tremendous value and can be overlooked by investors, who focus only on the Property-Liability oval. This strategy creates shareholder value through customer satisfaction, unit growth and attractive returns on capital. It also ensures we have sustainable profitability and a diversified business platform.

Moving to Slide 3, we had a strong first half of the year. We made progress on all 5 of our 2019 operating priorities. Revenues exceeded $11 billion with Property-Liability premiums up almost $0.5 billion over last year's second quarter. The Service Businesses revenue was up 26.6% to over $400 million for the 3 months. Net income was $821 million and adjusted net income was $2.18 per share, as you can see on the chart on the bottom. As a result of this strong performance, we improved the 2019 Property-Liability underlying combined ratio outlook by 1.5 points, which is about $500 million of underwriting income better than the original guidance.

Adjusted net income return on equity was 13.5% for the last 12 months. Adjusted net income return on equity is a broad measure of our overall performance since it includes investments, Allstate Life, Benefits, Annuity and the Service Businesses. Since this represents the returns we generate on all capital, it's the best measure for our operating results. As a result, in 2020, we will establish long-term adjusted net income return on equity targets. Consequently, we will not use the Property-Liability underlying combined ratio to provide annual guidance on operating results, but we will continue to use it in our dialogue and on performance. We're making this change since we're committed to being a leader in the amount and quality of our financial disclosures to enable you to assess our performance and investment potential.

Turning to Slide 4, we made good progress on all 5 2019 operating priorities. The first 3: better serve our customers, achieve target economic returns on capital and grow the customer base are intertwined to ensure profitable long-term growth. Customers were better served as the enterprise Net Promoter Score improved. As a result their policy renewals increased in the Allstate and Encompass brands, which is a key driver of growth, although the increases and improvement have been slowed. Returns remain strong, which we discussed, with all the businesses performing well except one portion of Allstate Annuities, which Mary Jane will cover.

Total policies in force now exceed $129 million, an increase of 46.8% compared to the prior year. SquareTrade policies grew to $84 million, reflecting the substantial expansion last August with a large U.S. retailer. Property-Liability policies increased by $772,000 on the prior year's $33.6 million, and the Allstate and Esurance brands grew 2.2% and 8.4%, respectively.

Proactive risk and return positioning of the $86 billion investment portfolio resulted in a total return of 7% for the last 12 months and generated $942 million in net investment income for the quarter. Performance-based investment income increased significantly for the first quarter of this year. Shareholder value beyond current earnings is being created through increased telematics usage and greater sophistication at Arity. SquareTrade is expanding into Europe and InfoArmor's identity protection offerings are being integrated into our strategies.

Glenn will now discuss our Property-Liability results in more detail.

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

Thanks, Tom. Moving to Slide 5, you can see that Property-Liability results remain strong. Net written premium increased 5.9% in the second quarter for almost $1 billion through the first 6 months compared to prior year quarter. This reflects policy growth in the Allstate and Esurance brands and higher average premium for auto and homeowners insurance [called] across all 3 underwritten brands. As you can see in the middle of the left table, total policies in force increased 2.4% to $33.6 million.

Moving to the bottom of that table, the Property-Liability recorded combined ratio of 95.8 was 1.4 points higher than prior year quarter primarily due to catastrophe losses. This was partially offset by a reduction in operating expenses due to a combination of sustainable operational efficiencies achieved through focused efforts on streamlining processes in automation and lower incentive compensation given higher growth targets this year. The underlying combined ratio, which excludes catastrophes and prior year reserve reestimates was 84.3 for the first 6 months of 2019, below the annual guidance, which assumed higher frequency of auto insurance claims. Auto physical damage severities were higher than expected; however, this was offset by a planned reduction in expense ratio.

As a result of this performance, we're improving the guidance range by 1.5 points to 84.5 to 86.5 for the full year of 2019. This revised range assumes lower auto claims frequency and higher physical damage severity as well as investments in growth initiatives, the logic of which we'll cover on the next slide.

Moving to the right-hand table, Allstate Brand Auto and homeowner insurance net written premium increased 5% and 6.5% compared to prior year quarter, respectively. Auto policies in force are up 2.5% over the prior year and average premium was up 2.7% compared to the prior year quarter. Homeowners policies increased by 1.6% and average premiums grew by 5.6% over last year. Esurance's auto insurance policy growth was 8.1%, which combined with average premium increases result in total net written premium growth of 9.6%. Encompass written premium increased 1.1%. Higher average premium more than offset the decline in policy in force. On the bottom of the table, you can see the underlying combined ratios remained strong across our brands. And this strong performance means that investment in growth will increase shareholder value.

Turning to Slide 6. Investments in profitable growth are focused on Allstate brand Property-Liability insurance. Attractive margins support investment growth for 5 reasons. First, auto and home insurance generates very attractive returns on capital, as you will see towards the end of our prepared remarks. Allstate has earned an underwriting profit in auto and home insurance for each of the last 8 years, reflecting a focus on profitability, operational excellence and timely response to external conditions.

Current results are strong, with a recorded combined ratio of 93.7 in the Allstate brand over the last 12 months. Allstate has operational strengths, including pricing sophistication, branding and with expanded total sales producers by 11% in the past 2 years. We also have successfully tested different combinations of growth levers in 6 markets over the last 9 months to provide us a roadmap to the best local execution. This comprehensive program is highly targeted by geography, product and customer segment. And we use a wide variety of tools, including advertising, customer experience initiatives, pricing sophistication, telematics and new agency technology.

While we're expanding these initiatives, they won't have a significant impact on 2019 policy in force growth. Unit growth is expected to accelerate in 2020 and 2021. This will slightly increase expenses from the current lower levels and have a small impact on combined ratio, but this is factored into the improved outlook for underlying combined ratio we just discussed.

On a longer-term basis, we're working to reduce other expenses that will provide us flexibility to positively impact growth and competitive position while maintaining attractive returns. As always, we'll focus on producing strong returns for our shareholders and we'll react quickly to any market conditions as they emerge. We're building off a position of operational strength to compete both with large well-known competitors and smaller regional competitors to achieve our strategic objective, which is increasing market share in the personal Property-Liability market.

Mario will now discuss results for Service Businesses and investments in more detail.

Mario Rizzo
Executive VP & CFO

Thanks, Glenn. Let's go to Slide 7, which provides detail on our Service Businesses. Consistent with the strategy to grow non-Property-Liability protection businesses, the Service Businesses continue to rapidly grow the number of consumers protected, with policies in force increasing 82.8% to 89.7 million. This is largely due to SquareTrade.

We will be changing SquareTrade's branding to Allstate for domestic distribution channels as we believe it increases sales and provides additional brand exposure without advertising investment. As a result of unit growth, revenues grew to $405 million, as you can see from the lower left table. Adjusted net income was $16 million in the quarter, shown on the lower right, a $14 million improvement over the prior year quarter, largely due to improved loss experience at SquareTrade.

We recognized a $55 million pretax impairment charge in the second quarter, following our decision to phase out domestic use of the SquareTrade brand name. Arity continues to invest in advancing our telematics platform and had a small loss. Total mileage analyzed is now about 14 billion miles per month and captures more than 400 trips per second.

Allstate Roadside Services revenue was $73 million for the quarter with an adjusted net loss of $3 million, slightly better than the prior year quarter. Allstate Dealer Services revenue grew 14% compared to the second quarter of 2018 and adjusted net income was $7 million. InfoArmor had revenues of $23 million with over 1.2 million policies in force. The adjusted net loss of $6 billion was related to growth and integration investments.

Slide 8 highlights our investment results. Investment results were also good in the quarter, as we were positioning for modest U.S. growth by extending duration on the fixed income portfolio and appropriately matching long-dated liabilities with equity investments, which increased income and valuations. The portfolio generated a strong 7% return over the last 12 months, of which 2.8% was in the second quarter.

Net investment income was $942 million, which included a rebound in performance-based results. The components of total return are shown in the chart on the left. The blue bar represents net investment income, which is included in adjusted net income and has varied between 80 and 110 basis points per quarter. Net investment income contributed 3.8% to GAAP total return over the last 12 months with a stable contribution from interest income on fixed income investments and a more variable contribution from our performance-based portfolio.

Valuations shown in gray and red vary on a quarterly basis due to investment market volatility. Since we have ample liquidity, we accept this volatility as it enables us to earn a higher risk-adjusted return. As you can see from the last 2 bars, portfolio valuations have been up this year, reflecting lower interest rates, tighter corporate credit spreads and higher equity market valuations. Increases in investment valuations have added 3.2% to our GAAP total return of 7% over the last 12 months.

The chart at the right shows net investment income for the second quarter of $942 million, which was $118 million higher than the second quarter of 2018. Market-based investment income, shown in blue, increased to $731 million from $696 million, reflecting investment at higher new purchase yields in 2018 and a duration extension of the Property-Liability's fixed income portfolio. The performance-based portfolio generated investment income of $261 billion in the second quarter, which was $85 million higher than the prior year quarter, reflecting strong private equity asset appreciation and gains on the sales of underlying investments. The performance-based portfolio also generated $37 million of realized capital gains, comparable with the prior year quarter. Our trailing 12-month performance-based GAAP total return is 9.3%.

And now, Mary Jane will provide an overview of Allstate Life, Benefits and Annuities and the special topic on the Annuities business.

Mary Jane Bartolotta Fortin
President of Allstate Financial Businesses - Allstate Insurance Company

Thanks, Mario. Let's turn to Slide 9. Allstate Life, shown on the left, generated adjusted net income of $68 million in the second quarter, $12 million lower than the prior year quarter primarily driven by higher contract benefits. Allstate Benefits adjusted net income, shown in the middle chart, was $37 million in the second quarter, $1 million higher than the prior year quarter as increased revenue was offset by higher operating costs and expenses. Allstate Annuities, on the right, generated adjusted net income of $52 million in the quarter, which was $8 million higher than the second quarter of 2018 due to increased performance-based investment income.

The special topic begins on Slide 10. The Annuity business grew out of the corporate strategy in the mid-90s of broadening into retirement-aiding businesses such as fixed and variable annuities. We built a broad-based business that filled a wide range of annuities in 6 different distribution channels: bank, broker-dealer, Allstate agencies, independent agencies, institutional brokers, structured settlements brokers. In 2006, we decided to not pursue growth in these areas because we did not have successful competitive positions. A highly competitive market constrained returns and led to liability structures that did not properly compensate for risk. As a result, we began a systematic process of exiting these businesses as market conditions permitted.

The variable annuity business was reinsured to Prudential in 2006, which enabled us to avoid the downdraft on equity prices that began in 2008. During the financial market crisis, we continued to reduce the size of the business. We exited the broker-dealer and bank distribution channels in 2010. We stopped issuing structured settlement in 2013 and in 2014, we stopped issuing all remaining annuity products until we sold Lincoln Benefit Life.

You can see the impact this had on the balance sheet in the lower chart, where annuity liabilities have been reduced from $75 billion to $18 billion, a 76% decrease. The result is our risk return profile has significantly improved and we freed up capital. Allstate Annuities now has 2 primary sources of income, $7 billion of deferred annuities and $11 billion of long-term immediate annuities. We aggressively manage these businesses to maximize long-term shareholder value, even if this means a negative impact on current accounting returns. And we do this in 4 ways: operational improvements and cost reduction; using a low-risk asset liability management strategy; investing in long-term assets to generate income for long-dated liabilities such as structured settlements; and actively managing capital. And as a result, adjusted net income from the deferred annuities is acceptable with returns in the low to middle double-digit, while the immediate annuities have a low return on capital.

So let's go through the 4 approaches on Slide 11, which provides more detail on our multifaceted approach to improve the long-term economics of this business. We have decreased crediting rates due to the declining interest environment, and contractual features such as maturity dates and limitations on additional deposits have been enforced. Approximately 84% of deferred annuities with declared rate contracts have crediting rate contractual minimums. Operational enhancements lower cost and reduce risk, and include expanded use of off-shoring and simplifying administrative processes. We are leveraging the best sources of mortality statistics available to identify the [things alluding] to reduce self-maintenance. And at the same time, asset-liability [matching] risk has been carefully controlled by positioning the portfolio to have ample liquidity for the subsequent 7 years. Expected cash requirements beyond 7 years are invested in performance-based assets to generate attractive risk-adjusted returns for the long-dated structured settlement annuities, some of which are expected to pay out over decades.

The risk and return gap is laid out in the table in the middle of the slide. The table shows U.S. broker bonds and U.S. equity return since 1920 and the volatility of these asset classes over different time periods, which is represented by the standard deviation. So let's start on the top line, where you can see in gray, a corporate bond had lower returns on a 1-year time horizon than equity. But the volatility has also been much lower.

When you extend the time period to 10 and 20 years, the relative return of bonds remains significantly below that of equities, but the volatility converges, which results in a much better risk-adjusted return for equities. And as a result, with a long investment horizon it is a much better choice to be invested in equities if you can handle the interim volatility, which we have done by ensuring your cash match for 7 years. This investment strategy, while favorable from an economic perspective, requires additional regulatory capital, which negatively impacts reported financial results.

And as a result, we actively manage capital to further improve the returns on our annuity business. Today, the equity investment capital requirement is focused on short-term input loss, similar to the volatility shown in the 1-year column table. We're leading industry efforts of the NAIC to recognize the long-term risk reductions associated with more balanced fixed income and performance-based portfolios. Utilizing horizon-based investment risk metrics should rightsize regulatory capital requirements. And we also continue to review strategic options to reduce exposure and improve returns of the business.

And now, I'll turn it over back over to Mario.

Mario Rizzo
Executive VP & CFO

Thanks, Mary Jane. Let's turn to Slide 12. We continue to generate attractive returns on capital with adjusted net income return on equity of 13.5% for the 12 months ended June 30, 2019. The Annuities segment, however, generates returns that are below our cost of capital.

As you can see from the table on the left, this reduced corporate returns by 3.7 points for the latest 12-month period. When you exclude the impact of annuities, Allstate's adjusted net income return on equity is currently 17.2%. The components of this return are shown on the right. Allstate Protection generates returns in the mid to high teens depending on the geography and product. Allstate Life has consistent low teens returns. Allstate Benefits is in the mid to high teens. Investments in growth are being made in the Service Businesses.

Beginning in 2020, Allstate will establish long-term return on equity targets, replacing the focus on annual Property-Liability underlying combined ratio. This broader and longer-term measure of performance will increase the operating focus on Investments, Life, Benefits and the Service Businesses, which in total deploy more than 50% of economic capital when you include the investments back in the Property-Liability business.

Today, some of the non-Property-Liability businesses such as Allstate Benefits, SquareTrade and InfoArmor get limited focus from the market, despite the fact that they have substantial value. Just the purchase price of SquareTrade and InfoArmor is worth approximately $5.75 per share. This measure also factors in capital management actions, is highly correlated with stock price and consistent with guidance that our peers provide.

Slide 13 highlights the continued strength of our capital position and financial flexibility. Shareholders' equity of $24.5 billion at the quarter end reflects an increase of $1.35 billion over the second quarter of 2018. Book value per share increased to $67.28 or 13.7% since the second quarter of 2018, reflecting strong income generation and appreciation of the investment portfolio. We returned $664 million to common shareholders in the second quarter of 2019 through a combination of $166 million in common stock dividends and $498 million of share repurchases, which includes the settlement of the accelerated share repurchase program. As of June 30, there was $1.6 billion remaining on the common share repurchase program.
Now let's open it up for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Gary Ransom from Dowling & Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

I have a question on market conditions. You mentioned in the Q that advertising and Esurance has less favorable economics, and I wondered if you could comment on what you're seeing in shopping behavior or volume or conversion that might be causing that?

Thomas Joseph Wilson
Chairman, President & CEO

Gary, it's Tom. So we manage -- and Steve may have a point of view here as well -- we manage the advertising expenses quite -- in a quite granular level down to whether it's top of the funnel, bottom of the funnel, which state, where we are at pricing, what we're doing with pricing. I don't think you should take away from that comment that we're not interested in growing in Esurance, that we don't think we have a competitive product as that advertising is not working. There was just a small blip down. I think it was down like 4% or something like that.

Steven Emil Shebik
Vice Chairman

Yes, yes, 4%. So Gary, we still have to follow up on that. What we did this year was -- following what Tom said, you go through our economic models, we look at where we are in terms of the market. So we had a -- entering the year, we had a few states where we thought we were a little touch and go on the profitability we wanted to achieve. And if you noticed in the second quarter in auto, we took some reasonable rates. We took substantially more rates in property also for the first and second quarters. So we've got the book we think where the profitability going forward looks good to us, and so we think that will be a better opportunity for us than advertising. Well, you never make sense to spend money on advertising when you think you -- in some of the large markets you may be a little bit off the price point.

Gary Kent Ransom
Dowling & Partners Securities, LLC

All right. Yes, that's helpful. I was wondering if you could comment if you're seeing anything in the Allstate brand as well? I mean it's different distribution, but is there any trends you're seeing either in shopping behavior or quoting or conversion?

Thomas Joseph Wilson
Chairman, President & CEO

I think if you just -- first, Gary, all the industry stuff is somewhat directional, but I don't think it is specific as what we actually achieved on ourselves. If Glenn can talk about where we're growing, in which markets. There is -- the market is slightly more competitive because people are doing the logical thing, which is if they are overpriced and are higher than we are, some of them are coming down. But that doesn't mean because the percentage change is negative that they're still cheaper than us. So it's really customers buying dollars, not on a percentage change. Sometimes they shop based on percentage change, but we're seeing -- there has not been a huge change in shopping behavior. Then Glenn, maybe you want to talk about our actual results.

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

Yes. I'll just add, Gary, that we've had good quoting. In fact, our quoting has been favorable the last year. You can see that new business results over a pretty high base year we were up slightly, 0.1%. So we felt good about where we were there. So we're seeing still good active movement in the market. As Tom said, you can look at the CPI numbers, and it was near double digits, so 18 months ago, now it's under a point. So it's a relatively rate flat environment. There's been some increase in advertising by some of our competitors. But that said, we have more points of presence now, up 2,500 points of presence year-over-year and the quoting activity has been good and we feel good about our ability to compete.

Thomas Joseph Wilson
Chairman, President & CEO

Yes. So it's a mark we're excited about, as we think there is an opportunity to grow. That's why Glenn went through the putting more money on there to invest in it. Like, we think this is a great opportunity. We're getting great returns, our brand is hunting, our pricing is good. We're ready to go.

Operator

Our next question comes from the line of Greg Peters from Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

My first question, I'll focus back on Slide 12 of your investor presentation around return on equity. I was hoping maybe you could expand further on how your new approach to guidance might look. One of the concerns or issues that I imagine you're dealing with is potential changes in the denominator book value because of the quarterly mark-to-market adjustments for your investment portfolio. And of course, then maybe at the end of next year, you're going to be adjusting book value for the yet to be announced adjustment related to long-duration contracts in your annuity business?

Thomas Joseph Wilson
Chairman, President & CEO

Let me -- Mario can answer the second piece. Let me just give you an overview. We're doing it because we think it's a better way to talk to you about how we're doing in total. As we said, when you look at just the underlying combined ratio and that becomes the whole focus of the conversation, [rather than] focusing on an important and significant part of the business, but it's not the whole business. And it was perhaps more important when the frequency of auto accidents went up in 2015 and people wanted to make sure we were reacting to that. So we've done that. And we've been doing it for 13 years, we've always been in there. But when you step back, Greg, and look at the impact on stock price, ROE is correlated to stock price. That's the measure we'd like to be held accountable to, but we obviously manage underlying combined ratio. But if you look at our underlying combined ratio, we have a very low underlying combined ratio. Other people have a higher underlying combined ratio yet they have a higher multiple than we do. And so there is not as good a correlation. So it's really about communicating to you all in the broadest way we can. There will obviously be some ups and downs as we deal with different accounting, as the accounting moves from more fair value and the whole balance sheet, so that bounces around. But that's just a math and an explanation issue and conversation we can have with you as to how we're doing and what we're doing. Mario, you might want to talk about the new accounting principles.

Mario Rizzo
Executive VP & CFO

Yes. Sure. Greg, so the first thing I'd say is just kind of reiterate what Tom just said at the end. So the ROE guidance we give you will take into account not only the projected profitability of our businesses, but also the denominator to your point and the amount of capital we have to hold, which will include whatever accounting standards happen to be in place at that time. So we're going factor both into the guidance we give you. In terms of the long-duration accounting standards, we're obviously well aware of it. The initial guidance came out in August. We've been monitoring it ever since. The FASB just this month indicated that they may potentially be deferring implementation by a year or so. It's still a little way's away. For us, as we've been disclosing for a number of quarters now, the impact will be material in our financial statements. It will principally impact our Annuities segment. It'll really do it in 2 ways. The first is through updating assumptions like mortality, morbidity and lapse assumptions on a regular basis.

That will affect retained earnings when we implement it and then the ongoing impact will actually affect the income statement. The second part is a remeasurement of our liabilities using a more current interest rate as opposed to the assumptions that were put in place at the issuance of the policy. Again, that's going to impact the balance sheet through ALCI. So we're focused on it. We're looking at it and when we have something to report, we'll give you more information on that, but in the interim the ROE guidance we give you will factor those kinds of things in.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

I'd like to pivot for my second question to Glenn's comments around the expense ratio for the Property-Liability business. I noted with interest in your results, really the pretty big improvement in both the Allstate brand expense ratio and the Esurance expense ratio. And I think, Glenn, in your prepared comments you talked about maybe some headwinds or some upward pressure in the back half of the year, but maybe you could spend a minute and talk to us more about what you're doing at the organization to drive an improved efficiency and the expense ratio? And what we should be thinking about that trajectory as we look out to 2020 and beyond?

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

Yes. Thanks, Greg. I appreciate the question. I guess I'd reframe headwinds as opportunity because what we're looking to do is invest and grow the business, which is a great return business. So we have made some good structural movement on expenses. And to turn that into some real tangible examples for you, operationally, we've done some things like in automation, we're using aerial imagery and available data in the market instead of going out and inspecting comps from an underwriting standpoint. So you could just think about the cost trade-off of doing that. We have improved customer experience by providing better information upfront, a streamlined onboarding process, and as a result, we have a 20% reduction on inquiry calls. So that's great for the customer, but it costs money to answer the phone and it ends up taking our costs down. Our procurement team has done a really nice job of leveraging our scale, improving our contracts and what we pay third-party providers. As you mentioned, Esurance's expenses are down, and that's been -- Steve talked about before some on the marketing and acquisition side of things. So we have some sustainable components to all of that. And as I mentioned in the prepared remarks, a part of it, a smaller piece of this is incentive compensation where we had higher targets this year for growth. Now you take that, if you take a small amount of that, you create this virtuous cycle to where you achieve expense advantage, you take a small amount of that and you invest in growth, you grow really high-margin business and it's ultimately a great win for the shareholders doing it that way.

Operator

Our next question comes from the line of Mike Zaremski from Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

I'll -- my first will be a follow-up to the expense efficiencies you're speaking to. I'm curious, so these structural expense efficiencies, do you feel these are kind of Allstate competitive advantages? Or do you feel like you just -- it's a first-mover advantage and the rest of the industry is kind of moving in that direction as well over time? I feel like the -- it feels like it's kind of -- you've been talking about these things for a while. It seems like it came pretty fast in terms of -- into the income statement.

Thomas Joseph Wilson
Chairman, President & CEO

Mike, this is Tom. I'll give you -- I think some are advantages, I think other places we're still trying to get our expenses down to where other people are. So I don't think we're perfect by any measure. I would say in the claims area, which was not included in the expense ratio we're talking about, I believe we're ahead. If you look at what we're doing with QuickFoto Claim, you look what we're doing with drones on adjusting houses, we appear to be faster and farther in integrating that into our business processes than our competitors. But I'd say, I believe because I don't [ghost] it in the Progressive or State Farm or GEICO, call or -- hindsights. When we're looking out at the industry, we think we're ahead there. There is other parts where we need to get more effective and efficient. So you've seen that at Esurance. We brought the marketing spend down. We don't have the brand consideration for that brand yet at a point where it's as efficient and effective as the GEICO brand, as they spend $1.7 billion; we spend a lot less than that. So the difference is getting smaller as we spend real dollars but we're not where they are. So I would say that when you look first at the competitors, it's -- we're in the hunt. We're competing aggressively, but we're all working to try to reduce our expenses even better because we can indeed do this. So one of the things we mentioned upfront is we're building this Integrated Digital Enterprise, which is about how do we use technology, data analytics and importantly, process design to reduce the expenses across all of our brands. And that will lead to some additional changes in the future as we try to cut out expenses by leveraging stuff across the whole system. Anything you would all add to that?

Steven Emil Shebik
Vice Chairman

The only thing I might say is we've mentioned advertising for Esurance. They have actually spent a lot of hard work getting their other operating costs out. So you look -- they have brought it -- about half of that decline in their expenses over the last year had been other operating expenses, which I believe are sustainable. That's based on customer experience, improvements to digitization. On the addition just the growth you got to believe that's 18 months and scaling. So we feel good about our position and the team is really focused on continuing that trend.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. That's very helpful. And my last question is, switching gears, in homeowners, paid claim severity is more volatile and seems like less trendable than versus the same -- than the auto side. Any color on how to think about what's going on with home paid claim severity given it increased to 11.7% this quarter?

Thomas Joseph Wilson
Chairman, President & CEO

Well, you're right that it's more volatile, and Glenn can talk about what we've been doing in average price, which I think is important to recognize. But it bounces around. But over time, over like rolling 12-month period, it should work its way out. But fire claim costs a lot; it costs a lot more than someone running into their garage door so -- and it messes up the severity. And so it does -- it is seasonal, but over time, it does work its way out and that's what you reflect into the prices, so we maybe want to talk about how you're taking that severity and what you're doing to maintain margin.

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

Yes. It's a great point Tom is making is that, that home unlike auto, the variation in perils creates a lot movement in that, but we look at the overall trend. If you look at homeowner over the past 6 years, we produced on average of 16% underwriting profit and 84 combined ratio. But the last 12 months was a 98, so 2% underwriting profit. So it is volatile. We've had a lot of weather in there, and we've been recognizing that in price and you could see in the year-over-year. And I always go to the average premium as opposed to the filed rates because there is a material difference between those. If we have inflationary factors in, average premium's up 5.6%. So we're definitely taking the weather pattern seriously. We're looking at rate and what we need to do from a pricing standpoint to make sure we continue to deliver those long-term profitable margins that we had in home.

Operator

Our next question comes from the line of Ryan Tunis from Autonomous Research.

Ryan James Tunis
Autonomous Research LLP

I guess just taking a step back on the expense ratio, just looking at just auto, I think Allstate has always been around a 25% expense ratio company. It was about 24% this quarter, which was clearly good. Some of your top competitors I think are around 20% or even a little bit lower than that. I'm curious, Tom, do you have a number in mind for what you think Allstate could get to over the next few years on the expense ratio?

Thomas Joseph Wilson
Chairman, President & CEO

Lower is better, sorry, and we have targets but do not target [that we] probably exposed. But we are working hard on Integrated Digital Enterprise using technology, make -- putting cabinet processes in place across all our brands to get that down and we're working had. It doesn't mean though, Ryan, that if we see an opportunity to invest, as Glenn said, to get really attractive business, we're not going to do that. We will not be a slave to just getting that down. We're -- our objective function is increase shareholder value, which is a combination of both ROE and growth. And so if we think we should invest to capture above cost of capital growth, we will do that and we get really good returns from that business. So if you saw -- is it possible that our investments in growth will go up? Yes, it's certainly going to go up in the second half. So that mean we're not reducing expenses? No, we're working hard on expenses on a whole bunch of projects.

Ryan James Tunis
Autonomous Research LLP

Understood. And then my follow-up was on the Slide 11 ROE, on some of that new stuff. I mean first of all, just to clarify, the ROE goal will include any type of drag that's coming from the non-B&C business, like the annuities? Like that something you're going to include and have to battle against?

Thomas Joseph Wilson
Chairman, President & CEO

Ryan, we would like to get people's opinions on that as to what works for you. We know we want to give you an ROE goal. We think it should be in total, because it ties to the thing, but it came up earlier. To the extent things change like the accounting for Annuities and new write-offs, stuff like -- we just have to have a conversation with you all to say -- and this is -- we think it's a better measure and it will give you more insights into how we're doing, including buying back stock and everything else. So we can't -- we're not going to give you the underlying math around the goal that we do. And we'll establish a long-term target, which we said, this is where we can run the business, but there will be a lot of dialogue about it. This is about increasing discussion and dialogue and shifting to a better measure.

Ryan James Tunis
Autonomous Research LLP

Understood. I agree, the total ROE approach makes sense, but presumably the easiest way to improve that total ROE would be -- it would seem to me to be a separation of the Annuities business or at least the immediate Annuities block. And I'm just curious are there any legal entity complications that would come with you trying to part ways with that business?

Thomas Joseph Wilson
Chairman, President & CEO

There is a lot of ways to accomplish it legally. There is now a separation law that's been passed in Illinois which gives us some additional opportunities. It -- that may not be the first place we choose to use the separation law, however. We have some other places we prefer to use it first. But the bigger issue on that one is finding sources of capital that believe that we do, that you should invest on a long-term basis to take care of your customers to make sure that they have --they're protected, but that they get the right return. So -- and it's a combination of, it clearly has a complications of which company it's embedded in, and you can always use reinsurance, but then you got complications of the capital stuff that Mary Jane talked about. We think that the regulatory capital required to have performance-based investment in long-dated structured settlements is just wrong. You wouldn't invest in a pension fund like that. Nobody does and regulations don't in fact support you not doing that. And to the extent the regulation supports you being at bonds, we think that's bad for policyholders. So we're just going to keep working the issue. We -- there is no silver bullet. There was no silver bullet when we started on this -- when I started this 2006 so we just keep working. But -- and then on the ROE thing, definitely the accounting will basically adjust to probably more than what the economics is. So that's not the exact way you want to get the high ROE on Annuities, by writing off equity, but that's what will end up happening with this accounting principle when it gets put in place.

Operator

Our next question comes from the line of Yaron Kinar from Goldman Sachs.

Robert Cox
Goldman Sachs Group Inc., Research Division

This is Rob Cox for Yaron. So the midpoint of updated underlying combined ratio guidance has 2 points of deterioration compared to 1 half '19. So you talked about rate increases earning in through homeowners in 2 half '19, and I was wondering if you could walk through the offsets. I know you mentioned potentially higher severity and, of course, the increased investments in future growth.

Thomas Joseph Wilson
Chairman, President & CEO

Let me first -- we're earning a really good return in the Property-Liability business today. The underlying combined ratio, the recorded combined ratio all generate extremely high returns. And so we're quite comfortable with where we're at and so we don't see that as a waving the flag that we think profitability is going to get worse or that profitability is not going to be attractive to shareholders. Let me start there. This is a really good business with really high returns and we like it. As it relates to the quarter-by-quarter stuff, what you're comparing is what we had versus -- you got to look at really the underlying combined ratio on a 12-month basis; you can't really look at it on a quarterly basis because it bounces around a lot. And what we've said is that the reduction of the guidance from the beginning of the year where we gave guidance, we're down now 1.5 points. That's worth about $0.5 billion. And that is -- reflects the fact that frequency is down from last year, and we're assuming frequency will stay down. Severity of auto, the -- particularly the physical damage coverages is up versus last year and up a little more than we thought when we did the original guidance. So we factored that in and we factored in the additional growth through it. So it's -- we don't get the components of that by quarter and you really have to look on an annual basis, but key message, we feel really good about profitability. We like where we're at. We don't see any big changes in the market coming, whether that be frequency of severity that we haven't anticipated that go into that number.

Robert Cox
Goldman Sachs Group Inc., Research Division

And just switching to the investment portfolio, was the extension in duration more of a strategic decision to offset the lower yield environment?

John Edward Dugenske
President

Yes, Rob. It is John Dugenske here. We -- as you know, we have stated that we dynamically manage our portfolio, and you can see that historically we've done a number of things to do that. And you go back to a couple of years, we've built up our performance-based portfolio. From time-to-time, we will favor one asset class versus another. More recently, we looked at potentially slowing growth in the economy in the U.S. and around the world, coupled with higher interest rates as interest rates crept up last year. And we thought that it made sense in the spirit of dynamically managing the portfolio to shift emphasis a little bit. Thankfully, we did a lot of that move to extend the duration last year -- about a year between last year, at the beginning of this year and it benefited returns. This year's interest rates have fallen pretty substantially. I don't know that I would view that as really taking additional risk. It's really more balancing the portfolio more closely to our long-run objective. Going forward, as we know obviously, we have a

Fed meeting today. I think there'll be some interesting information that will come out of that. But what I can promise you is that we'll work together as a team to look at where the best opportunity is across the marketplace.

Just a couple of tidbits of information, a lot has been said about where are interest rates now and what does that mean to the performance of the portfolio going forward. And I'll just remind everyone that back in 2016, the 10-year hit a 1.37%. It's hovering a little bit above 2% right now. And in the periods that ensued past that we were still able to return good returns in the portfolio, and that comes from all the things that we talked about historically. The good balance of different types of assets, whether it's market-based or performance-based around the world and active management. We'd also point out that this year has been -- it's been an attractive year for assets year-to-date. Only roughly 2% of the time had both the bond market and the stock market appreciated this much, if you go back 100 years. So we're just taking that into consideration, and we're happy that we managed it dynamically. Maybe somewhat comforting news on that though is that when you look back at those periods historically, it's not as if the bottom has dropped down in markets after that 12 months that have ensued after these periods historically. It's been okay in the market. So we're watching all this information, leaning on our team internally, leaning on our experts and external managers to figure out the best way forward.

Operator

Our next question comes from the line of Michael Phillips from Morgan Stanley.

Michael Wayne Phillips
Morgan Stanley, Research Division

My first question is, seems like a really big as a question, so I must be missing something pretty big, and so I apologize. The goal here is to grow more and you've got investments to make that happen, and you talk a lot about the investments around the expense ratio. I guess what I'm missing is, this quarter expense ratio was down because of lower incentive comped agents. It sounds like incentive comp would drive growth. So what am I missing there? Why would that come down?

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

Yes, Michael, this is Glenn. I would say, I wouldn't lead with incentive compensation on it. I would -- I'd list that somewhere down the list of things that drove the expenses. So we talked about some of the operational improvements that have been made and that has moved expenses, but we also acknowledge that a piece of it is in management expenses -- or management incentive compensation is a part of that because of higher growth goals this year. But we're -- as we talked about in this call, we're working hard, we have been and we're seeing some of the things come to fruition. And we'll continue to look at expense opportunities because we consider it a virtuous cycle. You reduce expense, you invest a portion of that reduction in growth, you grow really high-margin business and that's our target.

Thomas Joseph Wilson
Chairman, President & CEO

And from a philosophy standpoint, we should do better every year. So like the fact we raised the targets and there are advancements not yet at this target, so they're not getting paid on it, that's, like, okay. They are not dis-incentivized, they are hustling to get to higher targets, so what incents them is giving them good targets, stay on target, give them the resources to get it done. And so this is not -- it's not as direct to main line as due to not paying me so I'm not going to sell.

Michael Wayne Phillips
Morgan Stanley, Research Division

I guess on the severity, it's been rising a bit and still kind of is. Anything -- do you see any impact there from -- and I think this has been asked before, but maybe just any updates here? Any impact from tariffs that may be impacting the cost of claims?

Glenn Thomas Shapiro

President of Allstate Personal Lines & Director

So this is Glenn, Michael. I -- indirect, it can be in there, but we've seen a trend of increasing parts prices. Now you start -- you look at tariffs, and it's 60% of glass and more than half of replacement sheet metal parts do generate out of China. So you get a significant amount of impact in that space, but parts prices have been rising for the last 10 years at a much faster rate than the price of cars. And we talked about that in the past calls because you start getting into a math exercise where if the parts prices accelerate faster than the price of the car, therefore, repair accelerates faster than the car and more cars reach that capitation level of it's not economic to repair them and you have more total losses. So we continue to see that trend. As we look at the past 12 months, and I know this quarter was a bigger number and some of that's the year-over-year comparison not reflective of the absolute dollars that they moved. But we've seen essentially a 6-ish percent trend in property damage severity compared to a long-term trend of 4%. And so as we talk about our numbers and including in the guidance that we just dropped by 0.5, we have factored in what we believe is going to happen in the auto physical damage space going forward. So all the numbers are in there financially in terms of which you should expect to see.

John Griek
Director

Jonathan, we'll take one more question.

Operator

Then our final question comes from the line of Paul Newsome from Sandler O'Neill.

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

I guess the other piece I want to...

Thomas Joseph Wilson
Chairman, President & CEO

Paul, could you speak up, please? We can't hear you.

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

My apologies. I wanted to maybe beat the expense ratio horse just one more time. And I was hoping you could look out further into what sort of the pieces you'd be looking for to moderate prospectively in terms of the expense? Is any sort of commission levels involved in that or is that all just operating expenses?

Thomas Joseph Wilson
Chairman, President & CEO

Well, Paul, we don't give the components of it, but in total, we -- our customers want to pay less to get more. And so what we have to do is both figure out how to use less money, but then also how to improve the customer experience. So we are -- for example, Glenn has an effort going to build some integrated service capabilities where we will move work out of agencies into centralized centers, which eventually may even actually be done -- not needed anymore, because once we centralize then we can figure out how to redesign processes that make them not needed, much as we've done when Glenn was talking about getting rid of the 20% of the inquires. So there is a variety -- and so that will lower cost. At the same time, we're investing in new technology for the agencies called Allstate Adviser Pro which enables them to having much more fulsome, broad conversation with customers about their needs and what kind of protection they have. So it's a question of managing both the expenses down and the value. Glenn, anything you would add -- do you want to add anything on the integrated service or...?

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

I guess just the -- I guess the point in detail I'll put on that. If you think about our system, the value that we provide to customers, we think it's a really big differentiator as trusted advisers. We have agents across the country in people's hometowns that are providing them great advice on their insurance. That's the good news. The opportunity is that there is some inefficiency in providing the service in a decentralized way like that. So when you aggregate some of the transactional service components that customers don't value as much as that advice and you can do it at scale, you can take meaningful cost out of that system. So as Tom described, I think that's a great opportunity as we move forward.

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

And my follow-up was about maybe any updated thoughts you have on M&A? And I think you obviously explained the Services Businesses. There is some talk of expanding the business -- commercial businesses. Any thoughts of updating it in M&A?

Thomas Joseph Wilson
Chairman, President & CEO

Well, I would say, it's consistent with what we talked about. First, we look at stuff all the time. We're kind of picky. And the -- and so we have to be a better -- like when we look at companies we're like is there a reason for that we add value and we make this a better company. So we believe that the partnership we put together with SquareTrade has helped lead to that dramatic growth. We believe the partnership that we're building with the InfoArmor team, who have great growth, who is going to start selling that stuff through Allstate Benefits, low-cost distribution, we have to figure out how we get the Allstate name on it. So there is a lot things we can -- it's the middle of those ovals, that's what really the acquisitions have to do. We don't have anything specific on the list today that doesn't -- isn't consistent with this strategy you talk -- that you had and we just talked about. So there is -- well, just as it comes up, you will find us to be prudent, thoughtful and then the other thing that we'll do is as we've done with SquareTrade and InfoArmor, say here's our measures to success. We acquired the company. There is 3 things we think we need to do with it and then about every 6 to 9 months we go through that with you and say here's how we're doing. So it's fine. It's about being strategic deploying shareholders' capital well and then being fully transparent.

Thank you. So our strategy is to both grow market share on personal Property-Liability, we'll hard at work on that, and then grow our other protection products, which we've had great success on this quarter. And at the same time, making sure we deliver what we need to do on our annual operating priorities. So thank you. We'll continue to work hard on the shareholders' behalf.

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