S&P Capital IQ

CONTENTS

The Allstate Corporation NYSE:ALL

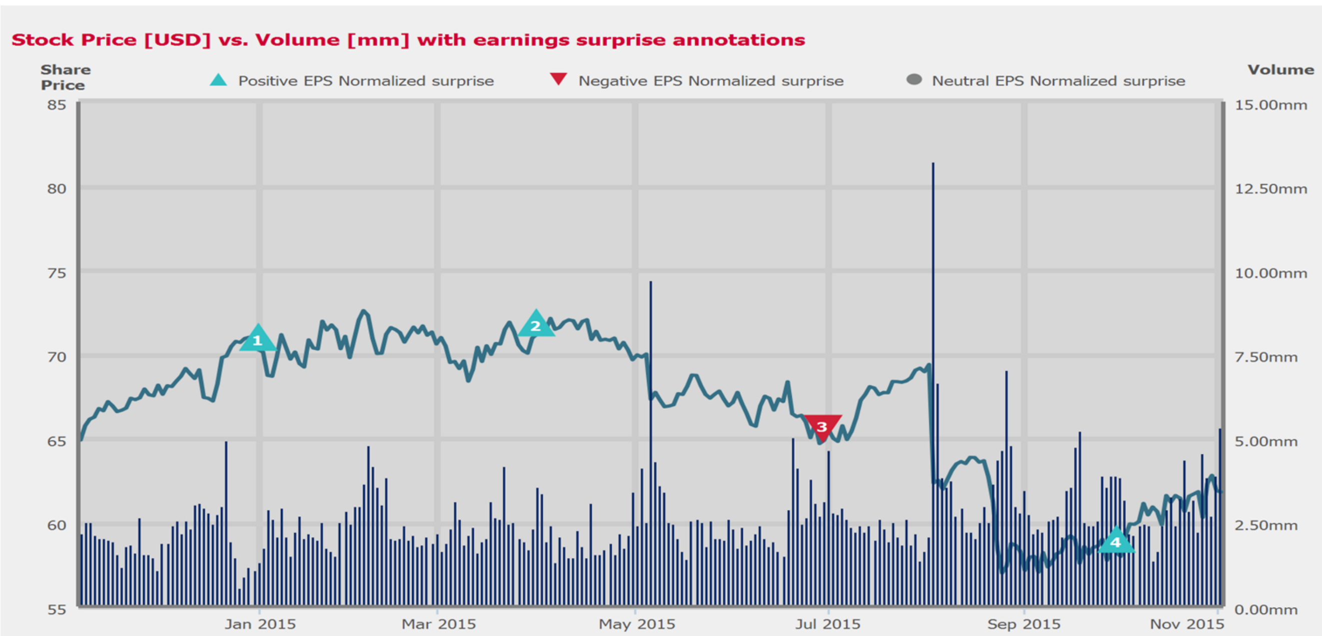
FQ4 2015 Earnings Call Transcripts

Thursday, February 04, 2016 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2015-			-FQ1 2016-	-FY 2015-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.33	1.60	▲20.30	1.38	4.93	5.19
Revenue (mm)	7714.27	7684.00	▼(0.39 %)	7770.10	30336.74	30309.00

Currency: USD
Consensus as of Feb-04-2016 12:29 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2014	1.68	1.72	▲1 2.38 %
FQ1 2015	1.42	1.46	▲2 2.82 %
FQ2 2015	1.02	0.63	▼3 (38.24 %)
FQ3 2015	1.30	1.52	▲4 16.92 %

Call Participants

EXECUTIVES

Don Civgin
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Matthew E. Winter
President and President of Allstate Insurance Company

Patrick Macellaro

Steven E. Shebik
CFO & Executive VP

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Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Allstate Fourth Quarter 2015 Earnings Conference Call. [Operator Instructions] As a reminder, today's program is being recorded. I would now like to introduce your host for today's program, Mr. Pat Macellaro, Vice President of Investor Relations. Please go ahead.

Patrick Macellaro

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

Yesterday, following the close of the market, we issued our news release and investor supplement and posted the results presentation we'll use this morning in conjunction with our prepared remarks. All these documents are available on our website at allstateinvestors.com. We plan to file our 2015 Form 10-K later this month.

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

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

And now I'll turn it over to Tom Wilson.

Thomas J. Wilson
Chairman & CEO

Well, good morning. Thank you for investing time to keep up on our progress at Allstate. I'll cover an overview of the results, and then Pat and Steve will take you through the details. Our comments today are more detailed on 4 topics to make sure we provide you with good transparency. I will spend some time discussing our rationale for 2016's underlying combined ratio outlook. Pat will provide more detail on the auto profitability plan. Steve will discuss the asset liability investment decisions, including Allstate's financial operating income -- and the impact that has on operating income, and then Steve's also going to provide some perspective on the overall investment portfolio. This -- that will include both the investments we're in, including limited partnerships and energy.

Also in the room today to answer any questions on any and all topics are Matt Winter, our President; Don Civgin, who leads our Emerging Businesses; Judith Greffin, our Chief Investment Officer; and Sam Pilch, our Corporate Controller.

So let's begin on Slide 2. We finished 2015 with a strong fourth quarter that was driven by our repositioned homeowners business, the continued progress in executing our auto insurance profit improvement plan and reducing expenses. The underlying Property-Liability combined ratio for the fourth quarter was 87.4, which brought our full year results to 88.7, which was within the original annual outlook range we gave last year at this time. The recorded combined ratio in the fourth quarter was 92.0, which generated $611 million of underwriting income.

The comprehensive program we implemented shortly after a significant increase in auto accident frequency and claim severity includes seeking higher approval for auto insurance prices, making changes to our underwriting standards to slow new business growth and addressing underperforming segments, which is both of those, and reducing expenses. This proactive approach, however, did not offset the impact to the external trends, and underwriting profits from our auto insurance declined significantly in 2015.

Continued strong results from homeowners insurance and moderate catastrophe losses resulted in operating from $1.60 per diluted common share for the quarter and $5.19 for the full year.

The return on equity on an operating income basis was 11.6% in 2015, down 1% from the prior year. Common shareholders received $691 million in cash during the fourth quarter and $3.3 billion for the full year through a combination of common share dividends and share repurchases.

So if we move to the chart on the bottom of the slide. Revenues were up 1.2% for 2015, and profit liability premiums grew by 4.8%. Net investment income declined 8.8% compared to the prior, and that reflects a smaller balance, which is due to the sale of Lincoln Benefit in April 2014 and the continued downsizing of our annuity business; lower interest income, which resulted from shortening the duration of our fixed income portfolio; and a slight decline in income for performance-based investment. Net income for the year was $2.055 billion, which was $5.05 per diluted common share.

Let's go to Slide 3. It shows our full year operating results for our 4 Property-Liability customer segments. So our total policy in force growth across all brands was 1.3% in 2015, as you can see at the top, and the recorded combined ratio was 94.9.

The Allstate brand, which is in the lower left, is our largest segment and comprises 90% of premiums written, and it serves customers who prefer branded product and value local advice and assistance. Allstate brand total policies in force in 2015 were 1.7% higher than 2014. Auto insurance, which is on that left-hand side of that box, new business and retention were both impacted by profit improvement actions. But policies still increased by 2.1% for the year. Homeowner policies grew over the prior year at a rate of 1.1%, and other personal lines grew by 2.7% compared to 2014. The underlying combined ratio was a strong 87.4 for this segment at year-end 2015, as you can see in the red box at the bottom.

Esurance, in the lower right, serves customers that prefer branded product but are comfortable handling of their own insurance needs. Growth was slowed throughout 2015 in this segment as our focus shifted to profit improvement. Policies in force were 1.4% higher at the end of 2015 than the prior year, and net written premium grew by 6.6%. The underlying loss ratio in Esurance improved by 1.2 points in 2015, ending the year at 75.4. As a result, the underlying combined ratio declined to 108.4, which includes about 4 points due to a number of expansion initiatives.

Encompass, in the upper left, competes for customers that want local advice but are less concerned about their choice of insurance company. This business decreased in size in 2015 as policies in force declined by 8.2% from a year over due to lower new business and retention, which is largely a result of price increases and underwriting changes. The net written premium decline of 2.8% for 2015, that reflects higher average premiums from increasing rates to improved returns. The underlying combined ratio was 92.6 for 2015, which was 1.1 points better than the prior year.

Answer Financial in the right upper right, that serves brand-neutral self-service customers and it's, essentially, an aggregator that does not underwrite insurance risks. Total nonproprietary written premiums are $581 million in 2015, were 10% higher than the prior year.

So let's go to Page -- Slide 4. Looking forward to 2016, we expect our annual underlying combined ratio to be in the range of 88 to 90. That range is comprised of a number of key assumptions. First, we assume that we continue the improvement in auto insurance profitability across all 3 brands, given the profit improvement actions we undertook in 2015 and that will continue in 2016. We do expect modest increases in both auto accident frequency and claim severity, which reflects the broad-based trends we experienced in 2015. Third, we assume the homeowners underlying combined ratio will increase slightly from last year's level. And as our profit improvements are realized, as we said, to realize the benefit of a lower combined ratio, we will continue to invest to generate long-term value, which will likely increase our expense ratio.

As you know, of course, predicting frequency and loss trends in a rapidly-changing external environment is difficult. As a result, we've put a range on our outlook every year. Now what you also know is that we react quickly to trends whether they are positive or negative to adapt our business priorities, so we're building long-term shareholder value. So our operating priorities for 2016 are designed to build long-term value, and as you can see, they're generally the same as 2015.

Serving our customers and generating returns and shareholder capital are our 2 top priorities, and they're central to our plan. When we do these well, we grow insurance policies in force. We intentionally slowed auto insurance growth in 2015 to improve auto margins. The new business typically has a higher loss ratio than more tenured business. New auto insurance volumes in the Allstate Brand declined by 24% in the fourth quarter as a result of higher underwriting, lower advertising and increased prices. While these actions are necessary, they're also flexible. So our appetite for new business will increase as the auto profit improvement efforts translate into a lower combined ratio.

The largest factor in overall growth, however, is a rate at which we retain customers. The auto retention rate declined in the fourth quarter in part reflecting higher auto insurance prices. We're implementing actions to reduce the impact that will have on growth. But what competitors do in their pricing is also a major driver, and that's not controllable. So our 2016 growth plans and prospects vary by customer segments. Growth in the Allstate brand auto insurance will depend on the timing of the success on implementation of auto profitability actions and competitors' pricing actions. The sooner we see a lower combined ratio, the sooner we will increase new business.

We do have growth plans in place for homeowners and other personal lines policies given the attractive returns on those products. We expect Esurance and Allstate benefits to continue to grow in 2016. Encompass had a decline in policies in force in 2015 and is not yet in a position to grow. So we're still committed to growing policies in force across the company, but it will be more difficult in 2016, and it has been in the past.

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

Patrick Macellaro

Thanks, Tom. I'll start with a review of our Property-Liability results on Slide 5. Beginning with the chart on the top of this page, Property-Liability net written premium of $30.9 billion in 2015 grew $1.3 billion or 4.2% over 2014. The recorded combined ratio for the year of 94.9 increased 1 point versus 2014 driven by an increase in auto losses, which was partially offset by lower expenses, strong homeowner underlying margins and catastrophe losses of $1.7 billion, which were 13.7% lower than 2014.

As Tom mentioned earlier, the year-end 2015 underlying combined ratio of 88.7, while 1.5 points higher than 2014, finished within our original annual guidance range given the strong results in the fourth quarter.

Net investment income for the Property-Liability segment decreased 4.9% from the prior year due primarily to lower performance-based investment income. Property-Liability operating income in 2015 was $1.9 billion, which was 8.2% lower than 2014.

The chart on the lower left-hand side of this page shows Property-Liability net written premium and policy in force growth rates. Red line representing policy in force growth versus prior year shows a slowing growth rate of 1.3%, given actions in place across all 3 underwriting brands to improve auto margins. Even with these headwinds, we grew policy accounts by 449,000 to 34.6 million in 2015 compared to 2014. The Allstate brand accounted for almost all policy growth in 2015 as Esurance policy growth slowed, and Encompass policies were lower than 2014. These policy growth results exclude 5.6 million Allstate Financial policies, which grew by 6.1% in 2015, driven by 11.1% policy growth in Allstate benefits. Average premium increases to reflect higher costs resulted in the net written premium trends you see shown by the blue line.

Bottom right-hand side of this page shows Property-Liability recorded and underwriting -- underlying combined ratio results. The recorded and underlying combined ratios both finished the year strong compared to results earlier in the year, given our actions to improve auto returns. The underlying Property-Liability combined ratio in the fourth quarter of 2015 was 87.4, and it was 2.1 points lower than the fourth quarter of 2014.

Slide 6 highlights the margin trends for Allstate brand auto and Allstate brand homeowners. Chart on the top left of this page provides a view of quarterly recorded and underlying margin performance for Allstate brand auto. As Tom mentioned earlier, our fourth quarter results continued to be impacted by elevated frequency and severity as they have been since the fourth quarter of 2014.

Our efforts to respond to higher cost trends through price underwriting and expense management resulted in an underlying combined ratio of 97.6 in the fourth quarter of 2015, which was 0.6 points improvement from the fourth quarter a year ago. On a sequential basis, the underlying combined ratio improved by 0.5 points compared to the third quarter of 2015.

Chart on the top right highlights trends driving the change in the Allstate brand auto underlying combined ratio. Annualized average earned premium per policy, shown by the blue line, continued to show upward momentum as rate increases implemented throughout 2015 resulted in a 3.9% increase in the fourth quarter of 2015 compared to the quarter a year ago.

Average underlying losses and expenses per policy in the fourth quarter of 2015 increased 3.2% compared with the fourth quarter of 2014, given the influence of higher frequency and severity but lower expenses per policy. The gap between these 2 points remains positive, but it's smaller than where it's been historically.

Similar information is shown for Allstate brand homeowners on the bottom of this page. On the bottom left, you can see that the favorable impact from low catastrophes that we experienced for most of 2015 continued in the fourth quarter, resulting in a 71 Allstate brand homeowners recorded combined ratio.

Lower frequency of fire claims in the fourth quarter benefited the underlying homeowners combined ratio, which at 56 was 5 points below the results in the fourth quarter of 2014. Components of the fourth quarter homeowners underlying combined ratio were in the chart on the bottom right. Average earned premium per policy increased to $1,085 or 1.9% over the prior year quarter. Underlying losses per policy decreased 6.6% in the quarter compared to the fourth quarter of 2014, resulting in a continued favorable underlying gap between the 2 trends.

Slide 7 provides some context on combined ratio and top line trends for both Esurance and Encompass. Chart on the top of this page includes fourth quarter and annual combined ratio of results for both companies.

Esurance's recorded combined ratio of 107 in the fourth quarter of 2015 was 8.5 points lower than the same period a year ago, given decreased investment in marketing along with a 5-point improvement in the loss ratio, which is reflective of ongoing actions taken in the business to improve auto returns. Esurance's combined ratio of 110.3 in 2015 improved by 7.4 points compared to 2014.

Encompass's recorded combined ratio of 95.5 in the fourth quarter of 2015 was 2.4 points worse than the prior year quarter and was adversely impacted by 2.9 points of higher catastrophe losses compared to the prior year quarter. Encompass's combined ratio of 102 in 2015 was 4.1 points better than the full year result in 2014.

Two charts on the bottom of this page show how growth is being impacted by profit improvement actions in both of the brands. In Esurance, policy in force growth slowed to 1.4% over the prior year and continued to decline sequentially while net written premium grew by 5.3% in the fourth quarter of 2015 compared to the same quarter a year ago. In Encompass, net written premium declined by 5.5% in the fourth quarter of 2015 compared to the fourth quarter of 2014 as the 8.2% decline in policies in force more than offset higher average premiums from increased rates and underwriting actions. As with the Allstate brand, we continue to evaluate our results, and we'll adjust profit improvement actions to ensure returns in both of these brands are appropriate.

Slide 8 provides an update on our ongoing plan to improve auto returns. As we discussed throughout 2015, our auto profit improvement plan is comprised of 4 parts, which are designed to work together to address the higher loss trends we're experiencing. First, we have sought approval for higher auto rate across the country. Second, we've implemented underwriting changes to slow new business and address specific underperforming segments business. Along with underwriting changes, we've also increased our ongoing correct classification programs. Third, we focused on claims operational excellence and precision. And fourth, we've reduced expenses across the organization to quickly impact the combined ratio while the other components took hold. These actions in total helped us to finish 2015 within our underlying combined ratio guidance range.

Details for the fourth quarter of 2015 are shown on the bottom of this slide. Approved auto rate increases for all 3 underwriting brands in the fourth quarter of 2015 were worth $401 million in net written premium while the total amount of approved rate increases for 2015 in total were worth $1.1 billion in net written premium, the highest amount of approved auto rate increases in over 10 years. We also continued to intentionally slow new business and make underwriting changes on isolated underperforming segments of business and geographies across the country to improve auto returns. These underwriting actions, in conjunction with our correct classification programs and price increases, have slowed new business and impacted retention. As Tom mentioned earlier, all of these actions are flexible, and they're all driven by local market conditions. We'll continue to adjust them selectively from market to market as auto returns improve.

Maintaining claims operational excellence and precision also continue to be priorities, given cost trends that we and others in the industry are experiencing.

Property-Liability expense ratio decreased by 2.8 points in the fourth quarter of 2015 compared to the fourth quarter of 2014. It was 1.2 points lower than 2014 at year-end, reflecting expense actions taken across the company. You can see the impact by underwriting brand in the chart on the lower left. These actions included reductions in advertising in the Allstate and Esurance brands as well as professional services costs and lower compensation incentives across the company.

Bottom right-hand chart shows the net written premium amounts generated by the rates we've received approval for over the past 3 years across all 3 underwriting brands. The Allstate brand represents the largest component of these rate increases, accounting for 942 million of the 1.1 billion for the full year of 2015 and 342 million of the 401 million for the fourth quarter of 2015. Rate and underwriting changes will drive customers to shop their insurance with other carriers, non-renew their policies or change their level of coverage, which will result in lower levels of premium in aggregate than what's shown on this chart. Allstate agency owners and their staff proactively consult with their customers during the insurance review process to write at the best coverage and deductible options for their specific situations and needs. We feel that having a trusted adviser to help guide customers' understanding a protection need during a period of rising auto prices across the industry is a key competitive advantage for us.

This analysis only includes rates approved through December 31. We continue to evaluate and run our business on a local, market-by-market basis and continue to adjust our actions going forward, whether it be through price, underwriting, claims excellence or expense management to ensure appropriate auto returns.

And now I'll turn it over to Steve, who will cover Allstate Financial investments and capital management.

Steven E. Shebik
CFO & Executive VP

Thanks, Pat. Slide 9 provides an overview of Allstate Financial's results for the fourth quarter and full year 2015 as highlighted on the top of the slide. Overall, we've made good progress in our Allstate Financial's focus and positioned the business to support long-term value creation. In 2015, we continued our efforts to fully integrate the life and retirement business into the Allstate brand customer value proposition and repositioned the investment portfolio supporting our immediate annuities.

Premiums and contracts charges in 2015 increased 4.2% when excluding the impact of the 2014 results of Lincoln Benefit Life company, driven by 5.7% growth in Allstate Benefits accident health insurance business as well as a 7.3% increase in traditional life insurance premiums.

Operating income for 2015 of $509 million was 16.1% lower than 2014, driven primarily by higher life insurance claims, the disposition of LBL and lower investment income. In the fourth quarter, operating income of $98 million was $30 million below the prior year quarter, driven by a lower fixed-income yield and a decrease in performance-based long-term investment income.

The bottom half of the slide depicts the liabilities and investments of our immediate annuity business. The approximately $12 billion of liabilities pay out over the next 40-plus years. Our Investment strategy is to match near-term cash flows with fixed income and commercial mortgages. However, for longer-term liabilities, we believe equity investments provide the best risk adjusted returns. As such, in the third quarter, we sold approximately $2 billion of long-duration, fixed-income securities to make the portfolio less sensitive to rising interest rates. Sale proceeds were invested in shorter duration, fixed income and public equity securities, which will lower net investment income in the near term. Over time, we will shift the majority of the proceeds to performance-based investments that we expect to deliver attractive, long-term economic returns, although income will be volatile from the quarter-to-quarter.

Moving on to Slide 10 and investments. I'll start with our portfolio of composition, at the top of the slide. We have a diverse $77.8 billion portfolio. Fixed income represents 74% of the portfolio value, with $8.6 billion or 15% at below investment grade.

As we have discussed previously, we are increasing and shifting the risk posture of our portfolio to deliver more attractive long-term returns. We created capacity for this incremental risk by strengthening our capital position to issuing preferred securities, reducing debt, exposure reduction to catastrophe-prone regions and shrinking our annuity business over the past 2 or 3 years. We are utilizing a portion of that capacity in our investment portfolio to increase idiosyncratic risk to performance-based investing and selectively increasing our high-yield holdings.

Our high-yield portfolio is conservatively positioned relative to the broader market, weighted meaningfully towards a BB, and to a lesser extent, B issuers. We have also managed with underweights at certain sectors, including metals and mining and energy.

Our portfolio breakdown by investment approach is at the bottom left. Within the context of these 4 approaches, we target asset mix that reflects our risk tolerance and liability profile. Our market-based core, by far the largest part of the portfolio, delivers predictable earnings aligned to our business needs. We seek to outperform the public markets and take advantage of volatility through our market-based active strategy. We have a growing allocation to performance-based investments, those that we term long-term and opportunistic, including private equity and real estate partnership and direct investments.

The majority of our energy holdings shown in the middle table are investment grade corporate bonds. We are conservatively positioned versus the broader energy market, preferring midstream and higher-quality exploration and production players, which we believe are better equipped to withstand the dislocation in energy prices. With that said, this is a dynamic environment and the implications of the falling energy prices are being felt across the market.

During the fourth quarter, $47 million of the trading losses of $82 million are the recognized impairments related to energy holdings. Losses were split between public and private securities.

Detailed and limited partnership holdings in our performance-based, long-term strategy are shown in the table on the right. Approximately 3/4 of the investments are in private equity, including timber and agriculture, and 1/4 in real estate. Likewise, approximately 3/4 are accounted for on the equity method of accounting, or the term EMA. Our performance-based, long-term strategy had strong results despite a lower fourth quarter, with 2015 being our second highest income year. We received significant cash distributions from realizations in this portfolio, which have reduced the amount on distributed income related to our EMA investments.

Moving on to Slide 11. Net investment income was $710 million in total for the quarter and $3.2 billion for the full year of 2015. Investment income and yield by business segment is provided at the top of the slide. In addition to a multiyear shift in the long-term mix, we continue to proactively manage the portfolio in light of current economic and market conditions. This includes reducing the duration of our fixed income holdings in both the Property-Liability and Allstate Financial portfolios, with the belief that the markets were not providing sufficient compensation for taking interest rate risk in the low yield environment.

To the left is Property-Liability. We reduced our interest rate risk in this portfolio in 2013, which resulted in a lower yield in The Allstate Financial portfolio. The yield is now increasing, reflecting our increased allocation to high-yield bonds as well as reinvestment into higher interest rates and our continued shift of the portfolio to performance-based, long-term investments.

To the right is Allstate Financial. We took actions in 2015 to make the portfolio less sensitive to rising interest rates, as I covered a bit earlier in talking about the immediate annuity business, which reflected in a lower interest-bearing yield in 2015.

Moving to the bottom half of the slide, at the left is our GAAP total return. The investment income component of the return has been fairly consistent while the valuation contribution was negative in 2015 on wider credit spreads across the market, with the majority attributed in our returns to investment grade securities given the weight in our portfolio.

In the middle is our realized capital gains and losses. In 2015, we had a net capital gain of $30 million, which included $470 million of net gains on sales, including the gains on long-duration, fixed-income securities we sold in the Allstate Financial portfolio, largely offset by impairments and intent write downs. The impact of lower valuations can be seen in the decrease on our fixed-income unrealized gains in the chart to the right.

Slide 12 provides an overview of our capital position and highlights the cash returns common shareholders received throughout 2015. Allstate remains in a position of financial strength and strategic flexibility. Our deployable holding company assets totaled $2.6 billion at December 31, 2015. Book value per common share was $47.34 as of year-end 2015, down 1.9% from 2014, reflecting lower unrealized net capital gains and losses on fixed-income securities. Excluding this impact, book value per common share was 4.2% in 2015 versus 2014.

We returned $3.3 billion in cash to common shareholders in 2015 through the combination of common dividends and common share repurchases. We repurchased 9.3 million common shares for $573 million during the fourth quarter of 2015, which brought the annual total to 42.8 million shares, 10.2% of our beginning-of-year common shares outstanding. As at December 31, we have $532 million remaining on our current repurchase authorization, which we expect to complete by July 2016.
Now let's open it up -- the call for your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Ryan Tunis from Crédit Suisse.

Ryan James Tunis
Crédit Suisse AG, Research Division

My first question, I guess, is just on the expense side. I appreciate there's a good amount of flexibility there, whether it's advertising expenses or just lower incentive comp. But I guess in the base case that you highlighted in your guidance that assumes, I guess, some step up in severity and frequency, how should we think about the Allstate brand expense ratio in 2016 relative to 2015?

Thomas J. Wilson
Chairman & CEO

Ryan, it's Tom. I'll make an overall comment, and Matt might have some perspective as well. First, you should expect the expense ratio to go up, because we -- this year, to make our goal, we did cut the advertising -- I wanted to improve some of the effectiveness of the advertising stuff anyway with some new advertising, and then we took some nice-to-do technology stuff and deferred it and decided not to do it and then cut some other expenses. And if you look at it over the quarters, you can see we increasingly reduced our expenses throughout the year, which was a focus. That said, there are a number of things we're investing heavily in and want to invest in terms of either long-term growth or short-term growth, everything from technology, I mentioned, to things like telematics. But, Matt, do you want to add anything to that?

Matthew E. Winter
President and President of Allstate Insurance Company

I think the only thing I would add, Ryan, is that, as Tom said in his prepared remarks, as we see the combined ratio in each local geography getting to an appropriate point and our loss ratios getting where they need to be and the profit improvement actions fully taking hold and rate burning in, we will want to be able to stimulate growth in selected areas as long as we're earning appropriate return, and growth requires some investment. And so part of the expense ratio next year will -- this year, I'm sorry, will be influenced by our growth plan and when we're able to turn on growth in certain areas and when we want to invest. We're focused on long-term value creation, and long-term value creation does require some investment. But it requires investment with appropriate levels of profitability, and so it's flexible. It will go up. The degree it goes up will depend upon thoughtful analysis of whether or not we are at appropriate profitability, appropriate margin and whether or not we're going to earn an appropriate return on the investment.

Ryan James Tunis
Crédit Suisse AG, Research Division

Okay. That's helpful. And then my follow-up is just -- I guess, in the supplement, you guys, a few quarters ago, started breaking out gross versus paid frequency. And the way I understand it is you incur the losses based on what the gross frequency is. And that's also what, I think, you guys tend to talk about and what the investment community tends to talk about. But the paid frequency number has been running significantly below the gross over the past several quarters. I'm just wondering how we should think about that. Is there possibility that you've been overestimating what frequency is?

Thomas J. Wilson
Chairman & CEO

Ryan, let me make that -- first, we think our reserves are appropriately established, so we do that in a bunch of different ways. We look at both gross and net. We look at what the original amount is. We do it by claims. So when a claim comes up, we put up some dollar amount for it. Then as the adjustor learns more, they keep building that up, and it leads to an incurred. And then, obviously, we think that we have to factor in future upward development of that, so we look at that as well. So we look at paid, incurred, incurred but not reported, and we come up with a number. Obviously, for things like physical damage claims, where they're really settled out in about 90 days, that tends to run through pretty quickly. The bodily injury, where it takes about 4 years before you get 80% paid out, has a little bit longer trend line on it. And as a result of that longer trend line, you tend to have more process changes along the way because you do things differently every year, and so that number tends to bounce around a little more. But I think we're appropriately reserved. I don't think you should think there is more or less in there than we thought. It's the right number.

Operator

Our next question comes from them line of Joshua Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Two questions. Tom, the first one is revisiting last quarter, actually, where you talked for the 4Q auto accident seasonality that did not seem to appear in this quarter. In the end, is it just a dream? Or is there something really there? Or what do you think?

Matthew E. Winter
President and President of Allstate Insurance Company

Josh, it's Matt. I'm going to refer you to a page in the appendix that we put in there. If you look at the presentation Slide 14, there's a whole bunch of drivers of the combined ratio and a whole bunch of drivers of even frequency. Some of them are controllable. Some of them are uncontrollable. Some of them, we can manage. And some, we can't. Even within the ones that are somewhat manageable, like new business quality and volume of new business and geographic mix, there's also some things that you just can't predict. Seasonality and weather, especially, is one of those completely unpredictable pieces of this puzzle. And so when we look at year-over-year, you can look back, we have some charts that show fourth quarter seasonality that tend to spike up. And then you have last year, where we had almost no catastrophes and benign weather. And this year, a much more normalized catastrophe year, but, I'd say, also a more normalized weather environment. Seasonality is one of those high-level generalities that tends to pan out over multiple years, but you can have dislocations and aberrations in that on a year-by-year and quarter-by-quarter basis. So I would not draw a trend line conclusions based upon 1 or 2 quarters and how they appear versus previous quarters.

Thomas J. Wilson
Chairman & CEO

And, Josh, I don't know I'm reading into your question, but it sounded like frequency was actually up quite a bit in the fourth quarter. So I couldn't tell what your underlying assumption was. Matt has a slide in there as well on the increase in frequency in the fourth quarter.

Joshua David Shanker
Deutsche Bank AG, Research Division

Right. I wasn't -- it's not really the frequency. It's just I was just looking -- in the past, and I always -- I'm anticipating fourth quarter being a tough comp every year. My other question -- look, I listened to your prepared remarks and I know you're going to invest in the future, and homeowners can change a little bit, but you did an 88.7% underlying combined ratio firm wide for 2015, and you have 5.5% rate increases coming through on the auto side. And you have guided to 88% to 90% underlying for 2016. It seems to me a very hard thing to believe that there's a world where the underlying combined ratio is going to be worse in 2016 than it was in 2015. Are you just being conservative? Or I mean, do you really think that, that's the right range in -- at 89% with a plus or minus 1 around it?

Thomas J. Wilson
Chairman & CEO

We think, it's the right range. I think we've been doing this since I became CEO. I think it's like -- it's maybe our 9th or 10th year that I've done this. We've never missed it. So we do it. So we think it's the right range, but that's reasonable. You get a 1-point swing either away from frequency and severity. I mean, you can get -- as Matt mentioned, you can't predict frequency. And to be honest, it's really difficult to predict severity within 1 point. So that alone gives you a 2-point spread. There have been some years, Josh, where we've had a 3-point spread, but that was when we weren't sure how quickly the homeowners business was going to take hold. And we did quite well. We got ahead of that, and it was faster than we had done in our modeling. But we do a lot of statistical modeling around this. We think it's about right. I mean, if you -- you're right, we -- you will see a lot of rate come through that, so $1.1 billion. And if loss costs and -- which is a result of frequency and severity, keep going up, which is what we have in our projections, we'll put more in rate increases. So no, we think it's the right number. I'm not -- we set it up to get there. And if you want to assume your case, then that would be in the middle range. We don't get so precise that we do it to 0.1 points. It's like -- I'd like to give just round numbers. And we think 88 to 90, we'll be in that range.

Operator

Our next question comes from the line of Amit Kumar from Macquarie.

Amit Kumar
Macquarie Research

Congrats on the print. Maybe, 2 quick follow-up on Josh's question. First of all, just going back to the discussion on guidance and rate increases. How should we think about the future rate increases? You've obviously had meaningful rate increases over the past few quarters. Are you factoring in that based on where we stand that number to diminish or continue to ramp up from here?

Thomas J. Wilson
Chairman & CEO

It will be reflective of our results in the cost basis. So if frequency and severity continue to increase, you'll continue to see us going to individual states with targeted rate increases. If it moderates, then I think you would -- should expect to see it come down some. But we can't -- we don't know for sure.

Amit Kumar
Macquarie Research

So I guess, related to that is what -- I mean, what are you baking in for frequency and severity here?

Thomas J. Wilson
Chairman & CEO

We have a plan, obviously, that we have frequency and severity. But when we move to do -- when we got away from EPS guidance, which I thought, in our business, didn't make a lot of sense, we said, we'll give you an underlying combined ratio guidance, which excludes catastrophe, so things we can pretty much predict. We think at 88 to 90, what happens with increases in frequency and severity, we can manage to it with the premium increases we'll be able to get next year. But we don't give out the specifics of components. That just ends up being -- it helps people do their models, but it turns our conversations into one of modeling as opposed to the pace of the business. We feel good about the business where it is. We'd like to make more money in auto insurance even though the returns are above our cost to capital. We've made much higher returns than that. Our competitive position and strength enable us to do that, and we're headed down that path. When we get there, we'll be dependent what happens with the external environment.

Amit Kumar
Macquarie Research

Got it. That's fair enough. And just, I guess, on the external factors. I know Josh was asking about this. One of the questions you were getting was the benign sort of weather in Q4. If you were to normalize it, would it be materially different to what you're looking at in Charts, I guess, 21 and 22? Or would it be modestly different?

Thomas J. Wilson
Chairman & CEO

So let me talk about it. So the fourth quarter, we came in and were able to get with -- inside our range, so at 88.7 for the year. The good weather really was a result. It wasn't really good weather, necessarily. The homeowners business did a little better because we had fewer fire losses, which tend to be big losses. I don't know whether that's weather or just luck. We, obviously, on the other end of that, which is completely controllable, as Matt pointed out, is expenses. We did a good job getting expenses down because we wanted them to be within the range. And then the profit improvement actions did start to go through. But Matt, maybe flip to -- Matt, take them to Slide 15, which shows the frequency. Just -- because I think everyone's saying it's like benign weather, and like we had a big increase in our frequency in the fourth quarter. And I don't want you to walk away thinking that it wasn't there.

Matthew E. Winter
President and President of Allstate Insurance Company

So Tom referred to Slide 15. What Slide 15 does is show what we believe is one of the primary drivers of frequency. As we've talked about on almost every call, frequency is driven by primarily miles driven but also weather, distracted driving, new business volume, new business quality and underwriting. And miles driven itself is driven by employment rate and gas prices, and we know what's happened to both of those over this last year. One of the confusing things is that I have referred in the past to the fact that the frequency trend is widespread, but I think some of you have taken that to mean that it is consistent across the country. It is widespread, but it is not consistent across the country. In fact, it's geographically varied. And Slide 15 is just some data from the Federal Highway Administration that shows how miles driven as of November versus prior year has gone up in each of the different regions. And you'll notice that in the Northeast, it only went up 2.9; while in the west, it went up 5.5; and South Atlantic, 5.1, et cetera. So this is one driver, but it's a major driver. And it does help to explain some of the other questions that you've been raising about why different companies have different experiences. They have different geographic concentrations of their business, their books of business, and the miles driven in those areas is different. It will clearly impact results.

Operator

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

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Allstate, just an observation, Tom. When you hit your forecast 9 years in a row, I guess it's another way of saying you tend to be conservative with your outlooks, because no one is that good to be able to forecast. My question...

Thomas J. Wilson
Chairman & CEO

I'm not sure what you're saying, Bob. I would say, look, we have a good system. We have a great team. They're goal-driven. They know how to deliver what we said we would deliver. If you had asked me last year when we gave our range of 87 to 89, did I think frequency and severity were going to clip up above 5 points, I would have said no. So -- but the point is you really can't forecast frequency in that. What I -- we can do is tell you, given the strength of our system and the transparency we have, our management processes in place, we think we can manage to 88 to 90 next year. And so that's what we've set out to do. If we do better than that, then that will be because we reacted well and did well. But we don't set it up so we can be below it, like that's not the goal here, because, obviously, as you would expect, you want to be balanced, thoughtful and transparent with your shareholders. You don't want to under promise and over deliver because then everybody will think all of the whole world has fallen apart, nor do you want to over promise and under deliver. So we try to do it on what we think the system can deliver, and we think 88 to 90 -- we did not set it up to be too optimistic or set out to be too conservative. It's right down the middle.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

I hear you. My question is, I understand all your profit moves, and I'm encouraged by the fourth quarter underlying showing some improvement, which suggests that you're on track. And I guess I understand what you're doing in Allstate brand and Encompass. On Esurance, trying to slow the growth dramatically certainly fits within your profit objective and seems like a sound way to go to achieve your short-term plan. But I guess my question is, are you where you want to be in scale in that business long term? And what is your overall sort of long-term game plan on Esurance? How big you have to be in that business to be a long-term player?

Thomas J. Wilson
Chairman & CEO

Well, let me make an overall long-term comment, and then Don can give you some specifics. So Esurance is quite to size from when we bought it 4 years ago or so. And we think it is of scale at $1.6 billion, because if you look at normal direct marketing companies, it would be 10% of your premiums, you would spend on advertising. And at $160 million, that's enough media weight to make sure people hear you. If you're half that size, you don't -- you just don't throw -- have enough throwaway in the marketing world. That -- so I think it's upscale today. That said, we have good growth plans, and I don't want you to think that this is a backing off of Esurance growth. Don can talk about the things we're doing to get into homeowners and motorcycle in Canada, new markets. So there's plenty of growth up there. We're just -- we're managing this year to some objective that Don had set for the team. So, Don, maybe you want to comment about it?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Yes. Bob, first, remember, when we acquired Esurance, we did it for the strategic reason of going into the lower right-hand corner with the self-serve, brand-sensitive customer and really focusing the customer value proposition against the GEICO and Progressive direct models. And when we acquired it, what we said we were going to do was run it for economics as opposed to GAAP accounting. So as you know, in the direct model, you expense all your marketing expenses upfront. And as a result, the first year or the first quarter looks particularly bad when you're growing. But then in later years, you tend to make money as the business retains, and you don't have to spend the marketing again. As Tom said, the business in now twice as large as it was when we acquired it a little over 4 years ago. It does have a meaningful impact on where Allstate reports. And with twice as much growth, we were having some pressure on the loss ratio. And so what we decided to do this year was slow the growth down, really focus on getting more efficiency out of our model. That meant both on the marketing side and on the operations side. And I would tell you I'm absolutely delighted with how they responded and how the business is doing. I mean, you talk about slowing down dramatically, it's still growing about 5% in the fourth quarter and more than that for the year. Not as high as it had been, but given the reduction in marketing, still a good growth rate. And the underlying combined ratio is down over 8 points from last year in the quarter, so feel really good about where they are. Having said that, I would echo what Tom said. The business is at scale. It could run at this size with meaningful growth rates, I think, and certainly do it in an economic way. But we do want to grow the business in the future as aggressively as we can. We just want to do it with a balance of profitability and growth. We felt that was getting a little out of kilter a year or 18 months ago. We're getting it back in line now, feel good about what they're doing. And the one other thing that amplifies is, I think Tom mentioned it in his comments, we had 4 points of investment in 2015 that shows up in the combined ratio, but you don't get the benefit of those investments in the current year. Things like expanding homeowners, which is now in 25 states; renters, which is in 20 states; motorcycle in 11; auto continues to expand to 43 states and 1, Ontario, in Canada as well. And so we are investing heavily in building our capabilities for the future, building out features and expanding our footprint. So we have -- I think the answer to your question is we have very aggressive growth plans for the future. We're investing heavily in that, but we want to make sure that we balance that with the economics and the reported results on a current basis.

Operator

Our next question comes from the line of Kai Pan from Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

First question on capital management, and it looks like you returned more than you earned in 2015. I'm just wondering base part of it, the capital -- like optimize your capital structure and going forward, is that going to be sustainable?

Steven E. Shebik
CFO & Executive VP

So if you look back over the last couple of years, we set up our share buyback program really in a basis of as you put a capital that we have available. We sold Lincoln Benefit Life, which we have both some capital and also the proceeds from the sale. So we moved that up to the parent company, $1.2 billion in 2013 and 2014. So in 2015, we used a fair amount of that, increased that buyback program for what might normally have been to the $3 billion level we're talking about. In addition, as I mentioned in my prepared remarks, we've done a fair amount of work at kind of bringing our risk profile down in the corporation, which once again has freed up some capital. We do need to grow the business. So if you look in the future, unless we can continue to change our risk profile, which we would say at the moment, as we said or as I said, we're going to put a little more money into our investment portfolio to back that into the equity-type investments, we will need some -- to put some money aside each year to grow the business. And we'll also have to pay our dividend, obviously. And what we free up essentially from net income, we pay out in -- on a year lag generally, in our share buyback.

Kai Pan
Morgan Stanley, Research Division

Okay. So we're looking more probably like payout ratio around 100% levels?

Thomas J. Wilson
Chairman & CEO

Well, we don't do it that way. That's, of course, the way the banks do it. But we do it the way Steve -- which is so we'll look at how much capital we need, then we say how much do we earn, how much do we have. And so we don't do it as a percentage of earnings.

Kai Pan
Morgan Stanley, Research Division

Okay. That's great. And then second question for Tom. It looks -- the change on Slide 4 of your operating priorities in 2016 -- or 2 things. One is -- the number one is "better serve our customers through innovation, effectiveness and efficiency." Could you give some example of that? And then the fifth item, basically the long-term growth platforms, now you mentioned about acquiring. I'm just wonder what -- like, what platform, like, policy current lag that you would like to grow into? And what's the appetite of your acquisition?

Thomas J. Wilson
Chairman & CEO

Okay. So let me answer the last one, and ask Matt to answer the first one. So first, in terms of the priorities, they are all important. So they're not -- like we don't fight over which order they're in. The -- and so Matt will talk about the customer, which is obviously very important to us, but as important as all the other ones. We did add -- it was a good catch on your part, Kai. We added the acquire to the build long-term growth platforms. Long-term growth platforms are the ones we're building to include things like telematics and what we're doing in roadside and Allstate Benefits and those things. We think if we need to acquire something to help accelerate those efforts, well, we would do that. Secondly, we believe that there is additional capacity in, particularly the Allstate agency channel, but also some in Esurance to pick up adjacent products and services, which are consistent with protecting and preparing people, particularly as Matt makes progress on the trusted adviser model in the Allstate agency channel. We think there are other things we could sell in. We could even decide we wanted to get into the business, do filings, create the product and that kind of stuff if it's unique enough. Or if somebody has a platform that we can buy and we can bolt it onto ours, we would do that. So that's the concept behind acquisitions. We didn't put it in there because we have some specific target or anything we want to talk about. Matt, do you want to go through that customer piece?

Matthew E. Winter
President and President of Allstate Insurance Company

Sure. Kai, so you correctly pointed out that it's customer-based, so it's all about customer centricity and using innovation effectiveness and efficiency, not just to manage financials and manage margins, but to better serve our customers. And there's 3 primary tracks of work going on under that category. The first, as Tom just mentioned, is trusted adviser. And trusted adviser is all the work we have under way to help our agency owners and their staff and our exclusive financial specialists better serve our customers through personalized, customized, tailored solutions, geographically based that are advice based, not product pushed, that are solutions as opposed to transactions and based on long-term value relationships. And so we have a lot of work under way there, and that goes to both the effectiveness of our agency system as a distribution model and the efficiency with which we put through product. The second major line of work that we have under way is we refer to it as our continuous improvement; others refer to it as lean engineering. And we've installed continuous improvement in a good portion of the company already. It's a set of management principles and practices that empower frontline employees, get them involved in root-cause problem solving, create flow of information, create an environment where they're engaged in their work. And we have seen dramatic increases in productivity and efficiency of those operations that we've installed continuous improvement. We've also seen a greater customer -- I'm sorry, customer satisfaction and employee engagement in those areas. The third, and this is on really the innovation inside, the track of work we have under way, we refer to it as Integrated Digital Enterprise, but you've also heard we refer to it as a set of projects that take data, predictive analytics and emerging technologies and combine those capabilities to better serve customers. And that includes a range of things that both use internal sources of data as well as external sources of data to provide more predictive guidance to our agency owners in serving their customers, to help them better serve those customers, tell them what the next logical product for them might be and to use those emerging technologies to deliver that in a way that's more accepted by the customer, more intuitive to the customer and is more respectful of the customer's time and energy. And so you will continue to see a lot of focus there. As Tom referred to in his opening remarks, as he explained why the expense ratio may float up a little bit, we will continue to invest in all these core initiatives because they're all about long-term value creation. If we're able to better serve our customers through innovation, effectiveness and efficiency, we will create a more valuable organization. And we're all about that, and so I thank you for asking the question.

Patrick Macellaro

Jonathan, we'll take one more quick one.

Operator

Certainly. Our final question comes from the line of Alison Jacobowitz from Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

It's actually Jay Cohen, as you could probably tell by the voice. Two questions, one is, you're obviously taking action as you've talked at length about to improve the auto profitability. And you suggested that, certainly, the effect will depend partly on what your competitors do. Question is, what are your competitors doing? What are you seeing out there? And then, secondly, relative to miles driven. Arguably, one of the reasons is lower fuel prices. Would you suspect that oil going from $100 down to $40 has a bigger effect than oil going from $40 to $30? In other words, the effect one might suggest would be declining over time.

Matthew E. Winter
President and President of Allstate Insurance Company

Jay, it's Matt. Those are 2 really good questions. First of all, what we are seeing by part of our competitors, some of our competitors is -- a significant rate action in the filings that we're reviewing as we make our filings, we see competitor rate filings as well. Some of them are quite significant. Some of them are more moderate. Most of it depends upon -- if you look back 3 or 4 years, the level of rates, they started this period. And so those who had a greater gap to cover in order to deal with the frequency and severity pressure are taking greater rate. So we expect that to generate some increased turmoil in the environment, and it will certainly generate shopping behavior in the industry. And shopping behavior can be a positive or a negative depending upon how you approach it, where you're positioned. It's all part of competition. So we're -- we believe we're well positioned. We believe we're prepared for it. We believe we're monitoring their actions, but we're mostly focused on what we need to do to earn appropriate returns and serve our customers. And so I would say our primary focus is always managing our own business with an eye towards what the competitors are doing as opposed to trying to react to competitors all the time, which I find can just drive you crazy. On your second question, it's a great point. There is a point of diminishing impact with gas prices on miles driven. We've always said that we thought the unemployment rate and economic activity had even a greater impact than the gas prices, because economic activity impacts employment driving, and gas prices typically impact only discretionary driving activities. Because if you have to go to work, you have to go to work, and you're going to pay $3 a gallon or you're going to pay $1.90 a gallon. If you're thinking about a vacation this summer and you're deciding whether to stay home or drive down to Florida, if gas is at $1.60, it's probably going to influence you differently than if gas was at $3.50 a gallon. Now there is a point at which though it's just plain cheap, and it's no longer a question. And I think we're probably at that point, so I think you're correct in that. From what we look at, we think the biggest influence of the drop in gas prices has already occurred. And it's unlikely that, that will drive much further increase in miles driven. But that being said, we also don't know what economic activity is going to look like and what all the other influences on frequency will look like.

Thomas J. Wilson
Chairman & CEO

So thank you all. I'm going to leave you with a couple of thoughts. Allstate has an extremely strong operating platform. First, that enables us to react quickly to whatever appears in the world. Secondly, we proactively manage our risk and return on a consolidated basis whether it's catastrophes, auto margins, investment returns or our capital structure. We look at it in total. And thirdly, we are focused on long-term value. We pay attention to current earnings because it is steps along the way, but we will not give up long-term value creation to short-term earnings because we believe that's what shareholders want, which is creating long-term economic cash value.

Thank you very much. We'll talk to you next quarter.

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