S&P Capital IQ

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The Allstate Corporation NYSE:ALL

FQ4 2010 Earnings Call Transcripts

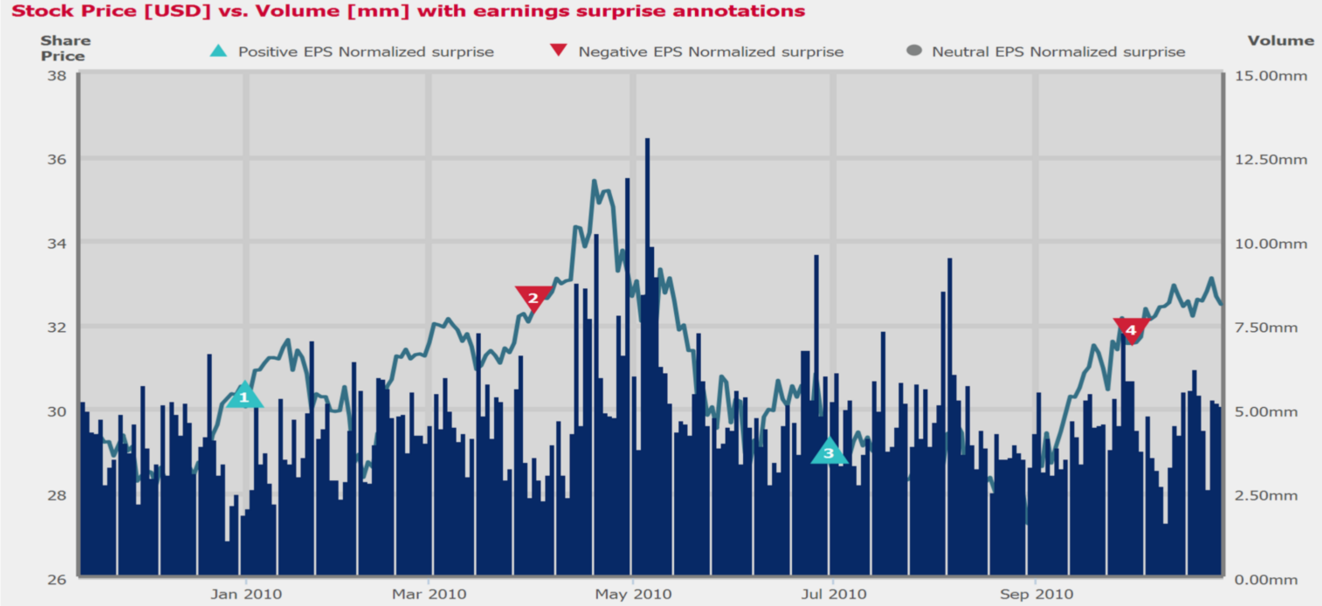
Thursday, February 10, 2011 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2010-			-FQ1 2011-	-FY 2010-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.88	0.50	(43.18 %)	0.88	3.23	2.84
Revenue (mm)	6490.79	6442.00	(0.75 %)	6647.03	26361.63	25957.00

Currency: USD
Consensus as of Feb-10-2011 1:36 PM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2009	1.01	1.09	7.92 %
FQ1 2010	0.88	0.69	(21.59 %)
FQ2 2010	0.72	0.81	12.50 %
FQ3 2010	0.96	0.83	(13.54 %)

Call Participants

EXECUTIVES

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Presentation

Operator

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

Robert Block

Thanks, Matt, and good morning, everyone. Thank you for joining us today for Allstate's Fourth Quarter 2010 Earnings Conference Call. As always, Tom Wilson, Don Civgin and I will make some opening comments, providing color on our fourth quarter and yearly results for 2010. Judy Greffin, our Chief Investment Officer; Joe Lacher, President of Allstate Protection; Sam Pilch, our Controller; and Matt Winter, President of Allstate Financial will join us for the question-and-answer session following our prepared remarks.

Yesterday, we issued our press release and our investor supplement for the fourth quarter. We also posted a slide presentation that will be used this morning. You can locate these documents on our website.

As noted on Slide 1, this discussion may contain forward-looking statements regarding Allstate's operations and actual results may differ materially. So refer to our Form 10-K for 2009, our 10-Q for the third quarter of 2010 and our most recent press release for information on potential risks. We expect to file our 10-K for 2010 by March 1.

Also, this discussion may contain some non-GAAP measures for which there are reconciliations in our press release and on our website. This call is being recorded and a replay will be available following the call. Christine Ieuter and I will be available to answer any follow-up questions that you may have once this call is completed.

Now, let's begin with Tom Wilson. Tom?

Thomas J. Wilson
Chairman & CEO

Good morning. We appreciate your continuing interest in Allstate. I'll provide an overview of our results for the fourth quarter and the year, Bob will then cover the business unit results, and Don will cover investments and our financial position.

Overall, we made continued progress in our business strategies in 2010 to position the company for long-term growth and raise returns on capital. Let's start by reviewing the numbers on Slide 2, and then I'll provide some context on underlying strategies and drivers behind these results.

At the top, revenues were flat for the quarter and down 1.9% from the prior year as actions to restore auto margins in several large states negatively impacted growth. We generated $296 million of net income for the quarter and $928 million for the full year. Operating income fell for both periods, reflecting higher catastrophe losses, lower net investment income and increased frequency of auto claims that's particularly true in New York and Florida. Book value per share increased 14.5% to 35.32 as compared to fourth quarter of 2009 number.

If you go to Slide 3, in Allstate Protection, we recorded an underlying combined ratio of 89.6 for the year, which was within our outlook range of 88 to 90. We did begin to see some signs of success in our efforts to grow our Auto business with increases as we move throughout the year and higher new business in most states. This resulted from our new Mayhem campaign and improvements in agency effectiveness.

We were not successful in raising customer renewal rates, so that the new business success did not result in overall growth this quarter. The actions we took in three large states to improve Auto profit margins negatively impacted the good work our agencies are doing in raising their service levels. Our Direct business, which largely appeals to the, self-directed, price-sensitive customers was up 19.8% for the year to $745 million.

Overall, Standard Auto policies in force were down 1.5% from the year ago and then essentially flat to the third quarter of 2010. We continue fixing Homeowners profitability with the average written premium for the quarter of 7% from the prior year. Catastrophe losses up, particularly a hailstorm in Arizona, however, offset these gains.

In Allstate Financial, we successfully completed the Focus to Win downsizing, exited the bank and broker-dealer distribution channels and began shifting our focus to underwritten products from our traditional focus, which was more on investment spread-based products. We also just announced our intention to wind down the Allstate Bank, which means we expect to no longer be a thrift holding company for regulatory purposes.

Operating earnings increased for the quarter to $104 million and finished the year with positive net income. We continue to improve the growth trajectory of Allstate Benefits formerly known as the Allstate Workplace Division. It's been very successful in expanding in both the small and large employer markets.

In investments, our strategies were well timed and executed and generally ahead of the market. We stayed long corporate credit and held onto the structured securities that we felt were undervalued by the market. We continue to mitigate risk by reducing our exposure in the muni bond and commercial real estate portfolios

We did spend over several hundred million dollars in our macro hedge programs to protect the portfolio's value if there were large increases in interest rates or declines in equity prices. Given the substantial increase in our capital levels in 2010, we will reduce the size of these programs in 2011.

We generated a good total return on both our Property-Liability and Allstate Financial portfolios for the year, but did experience a 7.7% decline in investment income. The net of these results is that we had large increase in book value per share, and we're able to initiate a share repurchase program in the fourth quarter.

Bob will now take you through the operating results in greater detail.

Robert Block

Turning to Slide 4, Property-Liability net written premium fell 0.6% for the fourth quarter and 0.2% for the year versus comparable periods in 2009. Overall, the reduction in units was partially offset by rate actions taken. Allstate brand's netted Auto net written premium finished the year with a slight increase over 2009.

For the quarter, the result was a small decline. The underlying trends were similar to prior quarters. New business application growth was flat for the year but increased almost 8% versus the fourth quarter of 2009 as you can see in the middle of the slide. Excluding the few large states where we have taken significant profit improvement actions, new business was up 19% and 13% quarter-over-quarter and year-over-year, respectively. Retention fell by 0.4 points relative to the fourth quarter of 2009, about the same level of decline we experienced in the third quarter of 2010 and is currently at the lower end of our historical range.

Overall, units in force were lower year-over-year but flat relative to third quarter 2010 levels. The average premium were comparable to fourth quarter 2009 levels, resulting from a combination of higher rates in underperforming states and rate investments made in key growth states.

Moving back up to the third line, Allstate brand, Homeowner, net premium grew just over 2% in both the fourth quarter and the total year. We posted increases in the average premium that more than offset declines in units as it has been the case for the last several quarters. Rate actions approved in the quarter affected 10 states, averaging 7.4%. Despite the rate activity, retention remains slightly higher than in the fourth quarter of 2009.

A significant source of net written premium decline remains in the IA channel, where we utilize the Encompass brand. Net written premium in total fell 17.5% for the year in Encompass as we direct our efforts to improve the overall profitability of the business. As Encompass strategically shifts back to its core product portfolio that independent agencies value, the decline in net written premium has begun to moderate to 10.5% in the fourth quarter of 2010 versus the fourth quarter of 2009.

Moving to a discussion of margins. For the year, the 2010 combined ratio increased 1.9 points to 98.1%. About 1/3 of the variance was due to higher catastrophe losses in the balance to the underlying business. The underlying combined ratio, 89.6, came within the outlook range of 88 to 90, as we provided you at the beginning of 2010.

As we look forward to 2011, we expect the underlying combined ratio to be within the range of 88 to 91. Remember that this measure excludes catastrophe losses and prior year reserve re-estimates.

We recorded an all-in combined ratio of 100.8 in the fourth quarter of 2010, a 7.6 point increase from the fourth quarter of 2009. When you break down that 7.6 point increase in the fourth quarter, catastrophe losses account for 3.3 points of the increase. Prior year reserve re-estimates, excluding catastrophes were worth another 0.4 points and the balance or 3.9 points came from the underlying business, primarily from the Allstate brands Standard Auto and to a lesser extent, Homeowners and Commercial.

On Slide 5, we provide a look at the loss components for Allstate brand, Standard Auto. On the left side of the exhibit, we show the reported frequency levels for bodily injury and property damage. To simplify the frequency charts, we averaged the 2005 through 2008 experience. The fourth quarter 2010 results follow the trends established over the last several years, with bodily injury frequency increasing 7.7% and property damage frequency rising 2.4% and are at their highest levels in the last six years.

There continues to be upward pressure on auto frequency. In the upper right-hand corner, we provide the quarterly increase and paid severity for both coverages since 2004. Both coverages declined in the quarter relative to the prior year and have performed very well over the last several years. This offsets some of the frequency pressure.

In the lower right-hand corner, we show the recorded combined ratio, as well as the trailing 12-month results. You'll notice the jump in the combined ratio in the fourth quarter of 2010. A similar pattern occurred in 2006, 2007 and 2008. It did not occur in 2009.

The movement in the combined ratio from the third quarter of 2010 to the fourth quarter 2010 was primarily the result of higher frequency levels, part of which is the underlying trend and part of which is seasonal. The auto combined ratio also was negatively impacted by current year severities, particularly, in personal injury protection. We will factor these frequency and severity trends into our pricing actions in 2011 to protect margins. Overall, the combined ratio for Standard Auto was 95.5 for the year, up 1.9 points from 2009.

On the next slide, we show similar components for Homeowners. The underlying, excluding catastrophe frequency, improved in the fourth quarter by 8.5% compared to the fourth quarter of 2009, while the paid severity rose 4.1%. The underlying loss ratio for the quarter was 47.9%, an increase of 0.7 points compared to the fourth quarter 2009. For the year, the underlying loss ratio was 49.4%, an improvement from 2009 of 1.8 points. We will continue to drive for improved profitability in this important line of business.

Switching to our results for Allstate Financial. On Slide 7, you see results for the top and bottom lines. Our strategy to shift focus to underwritten products and away from spread-based products continues. We generated over $2 billion of premiums and contract charges for the year, an increase of more than 10%. The primary driver of this increase was in accident and health produced through Allstate Benefits as this division successfully acquired several large employer accounts in 2010 and now stands as the number two player in the workplace voluntary market in terms of annualized sales. The total premium and deposits were $4.1 billion, down from $5.1 billion in 2009 as annuities are deemphasized.

Looking at the profitability results for Allstate Financial on the bottom half of the slide, we generated $76 million in net income for the fourth quarter, $58 million in net income for the year, a turnaround of $541 million from 2009. Operating income increased to $104 million in the quarter and $476 million for the year.

Remember, when you look at these operating income results for 2010, there were several favorable items that hit in 2010, primarily in the first two quarters, $26 million and $12 million, respectively. The first quarter related to our annual DAC unlock study and the second quarter related to reserve re-estimates and the recovery of a disputed reinsurance recoverable.

Breaking down the operating income into component pieces. The benefit spread was favorable in the quarter, first time this year. Investment spread was flat and as the continued downward pressure on lower interest rates and declining contract holder funds was offset by a lower interest credited in the quarter. Expenses increased in part due to non-deferred acquisition costs, emanating from the growth at Allstate Benefits. Allstate Financial made significant progress in 2010. Income trends stabilized. The focus on shifting the mix to underwritten products is working, and Allstate Benefits continues to generate profitable growth.

Now I'll turn it over to Don.

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Thanks, Bob. Slide 8 provides a longer-term look at the composition of our portfolio and the unrealized capital gain or loss by asset class. We came into the year with the portfolio valued at just under $100 billion and a pretax unrealized capital loss of $2.3 billion. We finished 2010 with a portfolio worth just over $100 billion, with an unrealized capital gain of $1.4 billion. During the fourth quarter, the unrealized position declined by $1.26 billion, driven primarily by a rise in interest rates near the end of the quarter.

Through our focus to reduce risk and optimize returns, we continue to favor corporate credit risk over municipal and real estate exposure. During 2010, we reduced our holdings in municipal bonds by $5.5 billion of amortized cost and commercial real estate exposure by $2.3 billion of amortized cost. Our municipal bond portfolio went from an asset allocation of 21% at year-end 2009 to 16% at the end of 2010. Our focus has been to lower our exposure to certain sectors such as appropriations debt and states and municipalities that are under budgetary stress. Our preferred segments of corporate and other fixed-income securities proved to have significant market returns during 2010.

Slide 9 shows trends for our portfolio yields, net investment income and duration. We had a drop in Property-Liability yields, as actions to shorten duration and reduce higher risk exposures impacted net investment income. This resulted from the fact that proceeds were reinvested in lower yields.

The decline in Allstate Financial's net investment income was primarily the result from reductions in contract holder funds. Overall, with rates rebounding and less risk mitigation activity, our yields and net investment income have shown limited deterioration in the current quarter.

For the year, total net investment income was $342 million below 2009 with lower assets under management accounting for about half of this decline. The balance of the decline came from lower reinvestment yields, offset partially by equity and partnership dividends.

Slide 10 shows trends for our realized capital gains and losses. The fourth quarter results were a net positive, $116 million, driven by derivative gains, gains from rate hedging, sales gains and improving limited partnership results. These gains were partially offset by impairment and intent losses in our real estate and municipal bond portfolios.

Both for the quarter and the full year, impairment losses declined substantially from prior year levels. Derivative results are primarily driven by interest rate management activities, which partially offset fixed income valuation changes. Macro hedge protection, which has struck well above market rates, protects against material interest rate increases. Even with the rate increases in the fourth quarter, these positions remained out of the money. The losses incurred from having this protection during a declining rate environment in 2010 was $206 million. ALM hedging and AP's duration management programs helped maintain targeted duration ranges and are struck at current market levels, having more sensitivity to changes in rates. While we saw gains in the fourth quarter, we incurred losses for the year as rates fell overall.

Finally on Slide 11, you can see our solid capital position. For the year, shareholder equity grew by $2.3 billion to $19 billion. Statutory surplus continues to be solid. Holding company invested assets grew to $3.8 billion after a $700 million dividend from AIC was made in the quarter. And as you know, the board authorized the $1 billion buyback in November. We repurchased $160 million of the stock by year-end 2010 under that authorization, which expires at the end of Q1 2012.
Now let's open it up for questions.

Question and Answer

Operator

[Operator Instructions] Our first question is from Bob Glasspiegel from Langen McAlenney.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Your underlying combined ratio guidance, if you take the middle of it, it's 89.5 which is roughly even with where you ended the year, 89.6, yet you're talking about Auto holding and Homeowners improving, why would I not be modeling the improvement in underlying the underwriting if that's your goal?

Thomas J. Wilson
Chairman & CEO

Bob, this is Tom. We provide the range to give you some sense for where we think the pace and the rhythm of the business is. It's a wider range this year than last year, specifically, because of the big performance of two states, which are New York and Florida, which, as you know, have large personal injury protection coverages and no-fault states, those states resulted to deteriorate substantially, and so that's a little more volatile. We believe we can fix that, so we don't necessarily shoot for the middle or the top or the bottom of the range, that's just where we think we will end up. We would obviously shoot to get the combined ratio as good as it can be.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Working the other way on the question. I mean, the last three quarter comparisons were underlying slips of one, two and then four points this quarter. So it seems like to get the underlying flat, it's going to take some work. You mentioned that maybe the year-ago comparison was tough. I think that was part of your opening remarks, but is down four underlying a fair state of where you are with the basis?

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

Yes, Bob. This is Joe Lacher. I don't think that's a fair state of where we are. I think a big part of that, and you could see it on Page 5 of the webcast, when you do year-over-year quarters, is the fact that the fourth quarter tends to be a higher quarter. Last year was abnormally low, so I think that's a bad measure to use, trying to do the year-over-year quarters. I think when you look at the overall number -- and the blue line on there actually shows a rolling 12-month average of the combined ratio. See the relatively flattening over the last four, five quarters except for a little uptick in the fourth quarter from an Auto perspective, and that really comes from the New York and Florida PIP and BI issues that we're talking about, that we're seeing move faster than we had anticipated. So our actions to improve those geographies and their places where they have those problems before, and we know how to handle them, are how we're thinking through our numbers.

Thomas J. Wilson
Chairman & CEO

Bob, put another way, the entire uptick in combined ratio -- most of that or large proportion of the uptick in the combined ratio is in those two states.

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

For the full year, the Auto combined ratio went up a couple of points, a little north of 85% of that's driven by the changes in New York and Florida.

Thomas J. Wilson

Chairman & CEO

So the rest of the business is running fine, we just got to fix those two states.

Operator

Our next question is from Mike Nannizzi from Goldman Sachs.

Michael Nannizzi
Oppenheimer

So of the seven-point increase sequentially in Standard Auto loss ratio, how much of that is the result of those two states? And if you were back those two states out, where is the underlying combined on the Standard outlook?

Thomas J. Wilson
Chairman & CEO

Mike, we don't, obviously, give guidance for just Auto alone. And I wouldn't necessarily look at that, I think, as Joe pointed out, wouldn't necessarily look at the seven points as the appropriate comparison. When you look at it year-to-year, it is up, and as Joe pointed out, 85% of it is in those two states. The rest of the states have an Auto combined ratio that generates a very attractive return on capital.

Michael Nannizzi
Oppenheimer

Yes, I wasn't asking for guidance, I was just asking if you back out those two states...

Thomas J. Wilson
Chairman & CEO

If we back out those two states, I think, it's about 91 on a full-year basis.

Michael Nannizzi
Oppenheimer

So 91 on a full-year basis for x those two states in Standard Auto.

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

Correct, that's what we achieved in 2010.

Michael Nannizzi
Oppenheimer

Can you talk about your decision to use an underlying combined as a metric. Kind of going through here the last several quarters, and you have this measurement that you hit your target, but yet, we kind of look at the results as the world at large looks at the results [ph] and you see the frictional impact of cat. Does it make sense to maybe think about putting a little bit more attention on that exposure, maybe giving people a heads-up as to what that's looking like when you're going to have meaningful exposure?

Thomas J. Wilson
Chairman & CEO

Mike, you're pointing out an issue we've had for forever in the insurance business because of the volatility. Let me tell you how we think about it, and then I'll give you some sense for what we've -- trying to find a way to help give you and other people better information on cats. First, if you go all the way up as what we expect to deliver to our shareholders: our good operational results; second to have the business strategically positioned for the future; and third, to make sure we have the right management team to execute those two things. And those are the kinds of things we need and want to communicate on. Underneath that first bullet is, obviously, the issue of how much you're going to make this year, this quarter. Because we've not been able to forecast catastrophes well, we said -- the only thing we could really give you that we feel comfortable in looking at the rhythm of business and making a judgment as to where the next year will be was excluding catastrophes and then prior reserve leases, which nobody factors those into their estimates. So the issue is with the weather different, that being, if you look at hurricanes, the water's warmer, the air is different, and so you have much larger, much more severe hurricanes. So when the hurricanes started to hit, we, obviously -- very difficult to forecast what your losses are after it hits, much less before the season. What's happened is you've seen a big increase in other related weather, so tornadoes, hailstorms, wildfires because of severe weather patterns. And those are notoriously difficult to predict. I don't think, if you would ask me, did I think we could have a $355 million hailstorm in Arizona? I wouldn't have thought the hail could be that bad in Arizona. It obviously, was. We are changing our pricing to reflect that, which is why you see the average Homeowners premiums is going up 7% this year, and you should expect to see it go up next year. It's very difficult though to give any kind of forecast until the event happens. We have looked at can we give you more information once the event happens, and which is a little difficult, because if we set up a structure to give it to you on the first of the month or the fifth of the month after a month, sometimes tornadoes happen on the 30th and the 29th, and you don't even have all the claim calls in yet. So it's very difficult to, even on a monthly basis, that we continue to try to find ways to come up with better information, but yet we haven't found any silver bullet.

Michael Nannizzi
Oppenheimer

I mean, one thing you just might want to consider is the storm is in October. Maybe if you give people some idea of what this looks like, then it might help when your earnings do come out, at least people will have some notion. And that would just be a suggestion if you might incorporate that.

Thomas J. Wilson
Chairman & CEO

Yes, I understand. We're open to any thoughts that -- and hope you guys can give us, because we, obviously, want you to know what we know when we know it.

Michael Nannizzi
Oppenheimer

As far as holding company liquidity, of $3.8 billion of liquidity. You had a relatively active cat quarter. You bought back some stock for the first time in some time, so how should we think about that? I mean, you're not -- it doesn't seem like the frictional cat activity is impacting your deployment. How do we think about that part of the equation?

Thomas J. Wilson
Chairman & CEO

Capital, I would say, we are long on capital. We continue to be long on capital. If you look at the capital on the various insurance companies, and Don quoted the numbers there, we are, I think, it's $15.2 billion of statutory capital. We feel well capitalized and capable of handling any volatility that comes from catastrophe, either because of the capital we have or the reinsurance programs we have in place. When you look at the holding company, we have $3.8 billion of essentially cash or highly liquid securities, and that is the area that we used to repurchase stock, pay dividends. And we have plenty of capital there. Whatever happened in this quarter will have no impact on our share repurchase program. And as we look at our models, we don't find a case in which we would not complete the $1 billion program we have out there and still have extra capital. And we continue to generate extra capital, in part, because our business is not growing as rapidly as we would like.

Michael Nannizzi
Oppenheimer

So maybe at $4 billion roughly of capital, you have less than $1 billion outstanding repurchase, your business is not growing, why -- and the date of your buyback is 2012. I mean, do you plan on being a $5 billion in holding company liquidity next year? Or kind of where is that number? Where do you want that number to be?

Thomas J. Wilson
Chairman & CEO

Mike, I can tell you, here is the way I look at those programs. One, if we don't have a use for the capital we give it back to the shareholders either through dividends or through share repurchases. We bought back about $19 billion of stock since I've been here. And so, if we don't have a use for it, we buy it back. I tend to lag a little bit, so that the company is stable, and we don't have to go look for money, because the worse time to look for money is when you don't need it. But when we put a share repurchase program out there, we put it out there, one that we will complete. Because if you look at the history of share repurchase programs, there are a number that -- or people talk about them and then don't actually get them done. We believe in finishing what we say we're going to do. And it's only once we weren't able to do that, which was on the financial crisis of 2008. So we put up, and then, we just buyback as aggressively as we can. So when we're done with this one, if we still have extra capital, we'll consider doing another one.

Michael Nannizzi
Oppenheimer

And you may finish it before -- I mean, so there's a chance you could up before this one expires?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Yes, that's it. There is a chance we'd do that, given that we bought back $160 million of stock in 45 days, I don't know that will always continue at that pace, but, yes.

Operator

Our next question is from Vinay Misquith from Crédit Suisse.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

First on the frequency, and I appreciate that about 85% of the frequency spike was in New York and Florida, but we've not seen this from some competitors. So if you could help us understand what happened differently at Allstate versus the competitors that you saw a higher spike in the second half of this year?

Thomas J. Wilson
Chairman & CEO

Vinay, this is Tom. I'll give you a overview answer, and then Joe maybe want to jump in and give you some more specifics. So it's difficult, of course, to compare our frequency to other people's frequency, because we don't know what happened to their business. And some of our larger competitors such as State Farm and GEICO, we actually don't see their numbers, so there's only a few large companies that you can see. And some of those companies also have change in mix of their business. So as you write more preferred customers, and as a percentage of your book and less high-risk customers, the weighted average of your frequency changes, that doesn't mean the underlying trend in your business isn't the same when you get down and look at the individual risk classes. That would be the first thing. The second thing I would say is the issues that we've seen in New York and Florida are not ours alone. So all you got to do is look at the press in Florida about how much fraud's going on with PIP. Our sense is in New York, when we look at the competitors, same thing is happening. Joe, you might want to jump in on the frequency and other...

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

I would add to that, Vinay. I think, if you look at Page 5 of the webcast, you can see frequency trends there. The black line's 2010; the blue line, 2009; the red line, the average of the previous 2005 to

2008. 2009, 2010, for our frequency numbers were higher than all of those prior periods, so this is not something that popped in the fourth quarter exclusively, there's been an underlying pattern there. And I think that's consistent with when you peel apart the way Tom talked about what we're hearing broadly across the environment. I think we end up being larger and more concentrated in personal lines than some of those players, so we don't have the underlying mix change. But there has been a consistent trend running in New York and Florida. You can look at the rate filings. You can look at conversations in the press, conversations with insurance departments. There's a consistency to this to the environment.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Should we be concerned at all about an adverse selection in terms of your retentions going down and the new business that you're adding?

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

I guess, we always have that concern and are sensitive to it and watching it, because issue or risk, you always have as an insurance company. One of the reasons we've seen the new business flat, when Tom and Bob described that new business was up outside of these states, is because we've tightened our underwriting programs and tightened what we're allowing to come in from a new business perspective in New York and Florida for exactly that concern.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Second question is on the retentions. It seems to be the lowest number, I think, since 2001. Just wanted to get a sense for what the drivers of that are? And I understand that you've been taking rates up in two states, California and Florida, but it seems that it's the lowest ever that I've been tracking. Just wanted to get a sense if there's something else that's really factoring into that number?

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

A couple of different thoughts on it. We have seen these retention levels before. I think, if you go back to the time that you're talking about, we saw some peaks two years ago, three years ago. So we're sort of operating at the low end of our range that we've operated in historically. Number two, the actions we've been taking in Florida, California and New York are aggressive defense of profitability, so it creates some disruption there. And we actually have been taking from a Homeowners perspective, also add to a little bit of that underlying disruption. So it's inside of a normal range, and we're actively trying to drive it back up to the middle and upper end of that normal range.

Thomas J. Wilson
Chairman & CEO

Vinay, this is Tom Wilson. Couple of other things I would say is one, it is our goal to do a better job for our customers, because this is not just the price game. A lot of people look at insurance and think it's only about price. It's not the way the market segments, if you do a fair amount of consumer research on it. So obviously, you also have to raise value. We've done a good job in a number of areas, but obviously, not good enough, because the number didn't go up across the country and that's a disappointment to us. But we have our agency loyalty scores. We track the performance of individual agencies. That was up about 5% last year. Index was, if you look at our claim operation, they've done a good job of increasing the amount of empathy and responsiveness they have. We have more work to do there, but it's also about raising the value that we provide to customers as well. And so we've tried to build a set of processes and programs in place, all the way down to our 401(k) plan pays out based on customer loyalty. So all employees are aware of it, and they're all motivated and compensated by.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Outside of those three states how are you seeing the retentions.

Thomas J. Wilson
Chairman & CEO

Retention is up outside of two or three large states.

Operator

The next question is from Keith Walsh from Citi.

Keith F. Walsh
Citigroup Inc, Research Division

I know in the past you've been asked this, about how Standard Auto, or actions on your Homeowners book, if they in fact, impact retention on Standard Auto. And I just wanted to ask it again, because it just seems that the trend continues there.

Thomas J. Wilson
Chairman & CEO

The answer is anything you do to customers that's negative, whether that's raise their average price in the Homeowners by 7% or put new risk management programs in place. So you're not writing their business, and you're brokering it to somebody else. If it's a cat prone area, have a negative impact on you. We try to do it in a way that is customer-friendly. And if you look at what models would say happened and what our actual results are, the actual results were able to manage our way through it, so it usually ends up being somewhere in the 20% to 30% of what a straight up model would show you. So we're doing a pretty good job of managing our way through it. It does show up in the numbers, but I think, that's just again about -- it's showing value. I'm not prepared to have us lose money on Homeowners when we have so much capital up on it to retain the Auto insurance. It's a challenge for us, as opposed to an excuse.

Keith F. Walsh
Citigroup Inc, Research Division

And then just turning to net investment income. On Page 9 of the presentation, you show sort of a $33 million variance in Property-Liability and a $45 million year-over-year in Allstate Financial. Is that a good run rate to think about, as we head into 2011, when we think about how net investment income will probably year-over-year look?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Let me make an overall, comment and then Judy will give you some sense for the underlying run rate in specific numbers. First, there's three components to our investment income. Obviously, there's volume; second, there's lower rates; and third is what you invest in. When you look at volume, the size of the Allstate Financial balance sheet is down on the contract holder fund, about 20% since the end of 2007. So the last three years we've brought that down 20%, and that's obviously because of mass shift to focus on underwriting profitability versus spread-based, so it rolls through that. It's not necessarily a big impact on operating income, because as well as you're losing the side of the assets, you're getting rid of the liability. So that tends to be a little more of a margin reduction as opposed to a straight up number that you would see in just investment income. Secondly, obviously, lower rates. Judy can talk to that. And then what you invest in is, obviously, important as well. Since 2008, we've been focused on total return and protecting the balance sheet. And if we didn't want to own something, we sold it despite its negative impact on operating income. So if there was a muni bond we didn't want, and it was paying a good rate, we sold it, even if that meant we had to, in the short term invested in govis [ph] or something like that. Because we said, let's just protect the balance sheet. That focus will shift now as we go into 2011 where we will be more focused on operating income, because we're kind of invested in what we want to be invested in now, we can start to manage income. Judy might want to talk about both that piece and lower rates.

Judith Pepple Greffin

Former Chief Investment Officer of Allstate Insurance Co. and EVP of Allstate Insurance Co.

So when I think about the first lower rates, the portfolio still has a higher book yield than market yield. Yet, that has been going down as market rates have gone up. So in the last quarter, you would have seen that our income somewhat stabilized and that was partially because during that quarter, we actually reinvest with higher. Reinvest yields were actually higher than the yields on our disposition, plus we didn't have as many dispositions in the fourth quarter. And as Tom had said, going forward, we have stabilized some of our risk mitigation programs. So when I look at market yields versus our book yields, as I've said, still our book yields are higher, yet market yields are rising, as we go into 2011.

Operator

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

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I was wondering if you could talk about your ad budget, maybe going forward, and what you're expecting to do this year with the campaign. And then also, I know it's still not fully through the quarter yet, but to the extent that you can comment, is it fair to expect insulated weather cat losses in the first quarter? And then my last question is you didn't really talk too much about California. Can you give more of an update in that state?

Thomas J. Wilson
Chairman & CEO

First, with respect to the ad budget. Let me go way up for a minute, and then swoop down to the ad budget, with the caveat that I'm not going to tell you exactly what we spend, because I care less that you know, but I care a lot that Progressive and GEICO know. So first, we decided we wanted to broaden our approach to the marketplace, make the brand a little more contemporary, and that we're going to spend more money, and we needed a -- we couldn't continue to run just one campaign, which was the Dennis Haysbert campaign, because it wears out, people get bored watching the same commercial all the time. So we came up with the Mayhem concept, which is very important, because it's about value. And the tagline at the end, dollar for dollar, nobody protects you better than Allstate, is because we want people to understand that it's not just about price, that's because that campaign is really targeted towards the core group of customers that come to us, which are personal-touch loyalists. These are people who want advice, want a local presence, want to buy multiple things from one company, and it's a portion of the market, where we overindex in our share. And so it makes us more contemporary and calls into question for those people. The contemporary piece and the kind of funny nature of it also happens to appeal to the other end of the spectrum, which is a self-directed, price-sensitive people, and who don't really care as much about local presence, don't want as much advice, more willing to do it on the web and do it through the call centers. So It happens to be kind of a one-two punch for us, it strengthens our existing programs, as well as broadens and makes us more contemporary. We like it. It's working. If you look at our quotes on our new business, it's way up. And so we're liking the results of that. We will continue that one-two punch, as we continue to try to serve both segments of the market with this value proposition. And I would expect we'll probably spend about the same amount of money this year as we did last year. The question on weather, who knows. It's February, whatever it is, 10 or something like that. It's been a dicey January. The bad news is there's been all kinds of bad weather. The good news is sometimes in this bad weather, people aren't driving. And then the question is how quickly does the weather get over? Does it turn into ice dam problems on houses? Does it turn the ice on roads and the people slip and crash into everybody when they believe it's safe to drive? I have no way of predicting what we'll do in the third quarter. And then in California, Joe can answer that question.

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

We're continuing to see -- there was no update for California, that's why we didn't talk about it. We're seeing comparable trends, and we're attacking them, and working on them and are confident we're moving in the right direction there.

Operator

Our next question is from Jay Gelb from Barclays Capital.

Jay H. Gelb
Barclays PLC, Research Division

Could you talk a little bit about the decision to exit the bank product in Allstate Financial? And if I go back a couple of years, Allstate also exited the Variable Annuity business. So I'm trying to get a sense, is this a trend towards narrowing down the offerings within Allstate Financial? And could Allstate maybe look to exit that business entirely over time?

Thomas J. Wilson
Chairman & CEO

Let me provide some longer-term perspective, Jay, for you on why we got into the bank, and Matt can answer very specifically how it relates to what he has going forward. We got into the banking -- we got a thrift charter in 1998. It was right around [indiscernible] when financial services companies were going to do everything for everybody, and we decided we should have one of those. We guide it, and we turned it into basically savings vehicle, which was a place to put money before you rolled it into annuities or life insurance in a way. And so that business grew to about $1 billion. Matt can talk about how that concept fits, and how he's going to execute in the future. But his conclusion, which he'll take you through with a little more specificity, was that it was not strategic. Given that it was not strategic, and it would subject the company to regulatory oversight at the holding company level, which had the potential, and I say only the potential, to conflict with this state-based regulatory environment we're in, we decided it was not necessary to continue to own that business. As it relates to variable annuities, variable annuities was a different situation. We just didn't like the economics. We thought people were giving it away. It wasn't age-rated, it wasn't health-related. We didn't like all the features on it. And we sold it to Pru [Prudential Insurance Company of America], because we didn't like the product mix. It didn't mean we didn't want to sell the product to people though, so we continue to sell variable annuities through our agencies and the EFS that's just other people's.

Matthew E. Winter
President and President of Allstate Insurance Company

Jay, it's Matt Winter. Let me start out by kind of explaining what we're trying to accomplish at Allstate Financial right now, which is we're looking at it from two perspectives. First, to add an element of financial stability and higher business returns to the business; and secondly, to focus on adding strategic value to the corporation. So as we looked at the first prong, the financial stability and business returns, we made a decision that in order to decrease some of the volatility in that business result, we needed to change the mix of business and move away from some of the spread-based businesses and increase the proportion in our portfolio of earnings that come from mortality- and morbidity-based businesses. We find that the profile of those earnings is more appropriate for where we are in this enterprise. And so a lot of what we're doing is trying to get to a more balanced perspective in a mix of business and slowly allow the spread-based businesses and some of the investment-related businesses to roll off while we build mortality- and morbidity-based businesses, and at the same time improving the new business and continuing business returns. So a lot of the decisions we've made about product lines to exit has been a result of that. So that's one of the reasons we stopped manufacturing our own book value and annuities. The issue with getting out of the Banking business has more to do with the second prong, which is the strategic value. Once we stabilize the organization financially, we want to make sure we're focused on adding strategic value to the enterprise, which we think we do in one of two ways, by either bringing new customers to Allstate or by helping existing customers develop a deeper relationship with Allstate. And the products that tend to do that best are the longer-term products, the mortality- and morbidity-based products that last for five, 10, 20, 30-year products, they tend to change their nature of the relationship from a transactional relationship to a longer-term relationship. And as a result, as we look at the products, we want to manufacture and offer. We want to concentrate on those products that will add the greatest strategic value to the enterprise and the customers. The banking products tend not to do that. They are quasi-transactional, they're shorter term in nature, and they don't fit within our overall strategic and financial objective of growing mortality-, morbidity-based business and entering into long-term strategic relationships with the customers that, in addition to the regulatory issues Tom mentioned, led me to the decision to recommend to the corporation that we exit that. We'll still offer those products to our customers. We still believe in the ability to deepen the relationship a little bit with that. But it doesn't necessarily have to be with a product that we manufacture.

Operator

Our next question is from Matthew Heimermann from JPMorgan.

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

One, just -- if you change the hedging in 2011 versus 2010, can you talk a little bit about where that cost reduction will actually show up? How much is balance-sheet versus income-statement-related? And then the second question I have is with respect to -- as you think about 2011, 2012 and rather than strategic factors, just maybe, think about what do you think the most important operating factors are, excluding the loss ratio, x cats and development that you're kind of focused on to measure progress this year.

Thomas J. Wilson
Chairman & CEO

Matt, let me -- on the macro hedging programs, that largely goes through realized capital gains or losses and which shows up not in operating income, obviously, but in net income, and then obviously, that translates into book value per share. So that's how the math of that piece works.

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

On the interest rate swaps, if there was -- so that actually -- including the make whole or make...

Thomas J. Wilson
Chairman & CEO

That goes to realized gains or losses. That doesn't get rolled up into investment income, which makes sense because what you're trying to do is protect the balance sheet. You could argue about whether ought to be marked-to-market and go through realized or not, given that some other stuff doesn't go through realized but that's battle for the accountants to fight not for us. Secondly, I'm going to interpret your question broadly and then come back to the specific things that we're focused on for this year. So first, I think, the thing you and other shareholders and analysts at the company should be looking at is one, how are we doing operationally; and two how are we doing strategically; and three, what does our team look like, and how are they performing. When you look at operational results, we obviously need to improve our Auto results in New York and Florida. So it's something that I'm spending time looking on. Joe's working hard on getting that team organized to drive the results. We do need to grow the rest of the country, but I am prepared to not grow, if that means we have to give out too much margin in Florida and New York. So everybody wants us to look at combined ratio and growth, I'm just telling you how I think about those two with some sort of components down below it. We obviously, need to continue improving the Homeowner business. I think we made good progress on it this year, but we have more to go there. At Allstate Financial, we need better integration into the Allstate agencies. So our cross-line sales need to be going up as well as our workplace business needs to continue to grow. That business has really grown rapidly. It's a hidden gem under there, which nobody really wants to talk about much, but it is a great business that's doing quite well, and we're very pleased with it. From the investments side, we need to continue to generate both operating income and growth in the overall balance sheet. So we will manage between those two. We talked a little bit earlier about before our efforts were primarily focused on the balance sheet, and we were less focused on operating income. This year, we'll be a little bit more focused on what investment income is, as well as managing the total return. So we're not giving up on one, but we're prepared to -- life is always about a set of offsets and trade-offs. So the net of all of those, really, are as you know, operating income, book value per share, two measures that you and everybody else look at importantly. Strategically, we need to continue do a better job and reposition our

Allstate agencies around the personal touch loyalists and make sure we're doing everything we can do for them, which means customer retention going up, selling more Allstate Financial products, have more cross-line relationships between Auto and Home. So there's a lot of work to be done and in making sure our agencies are as effective as they can be. We need to work a little harder on what the value proposition is for the sell-through, price-sensitive people that goes to our direct businesses. As I mentioned to you, our direct business, it was up 19% this year, $745 million, that's a real business. It's growing quite rapidly. That customer segment wants things a little differently than the customer segment that wants it through the Allstate agencies. It's not just about price. People don't just migrate to those channels because of price. They migrate to those channels also because of the offering. Price is obviously important. So we need to work a little harder on that piece. And then organization, if you look at our management team, well over half of our senior management team has been here about three years or less. We need to just continue to make sure we function effectively as a team. I feel like we have got our legs under us now, and we can continue to deliver good results.

Operator

Our next question is from Meyer Shields from Stifel, Nicolaus.

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

I guess, the key question in auto is whether the overall policy in force, or growth trends, however, you want to look at it, is the aggregate impact of California and New York and Florida versus the rest of the country getting better or getting worse?

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

Are you talking about top line or bottom line?

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

Top line.

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

Well, I think we've mentioned to you that the new business stats, ex those states, were up year-over-year. And I think Tom mentioned that retention was better in those other geographies year-over-year. So the measures of items in force are better when you put those two together than they are in those three big states. The issue for us is those are three big states for us that represent a large portion of the organization, and we're going to relentlessly drive to get the profitability right in those and not try to drive growth overall by selling things at a loss.

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

When you look at, I guess, the rate actions that you are planning for this year and what you've seen so far from competitors, rate filings, is there any chance that volume in those states stabilizes in 2011?

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

It's a different story when you go state-by-state. that becomes a tough question to project what we think competitors are going to do from a rate filing perspective. And I hate telegraphing to them what we're doing with any specificity. So there's always a chance in that, that will occur. I think those are difficult environments, where we have a broad set of industry issues and a broad set of industry challenges with PIF and BI. So I hope that's what we see.

Meyer Shields

Stifel, Nicolaus & Company, Incorporated, Research Division

There was an other personal lines reserve charge, I think, cost of that's $0.10 per share in the quarter. Can you talk about what's going on there? Because I think relative to the amount of reserves for those products, it seems like it's pretty significant.

Thomas J. Wilson
Chairman & CEO

I'm not sure which specific, why don't we follow up. There's a variety of things going through reserves. Obviously, we've moved some money around on lead paint, we obviously had some pit stop going on. So I'm not sure which specific piece you're looking at and what report you're getting it from. If you just follow-up with Bob, he can get you the specific number.

Operator

Our next question is from Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I'm looking at 5,000 Standard Auto drivers added. I'm wondering how the Mayhem is playing into that, and what that means for 1Q, which tends to be a very difficult quarter for you guys to add customers?

Thomas J. Wilson
Chairman & CEO

Josh, it's Tom Wilson. I don't know that first quarter is any more difficult than any other quarter to add customers is my first reaction. They're all hard. But as we mentioned a little earlier, the Mayhem program is working. Quotes are up, paying consideration's up. The way in which we're quoting those people, we're being more effective at it, so we're liking the new businesses. Joe just pointed out, we are growing in most other states other than the ones where we're working hard on to getting the profitability in place, which is in part a result of the Mayhem campaign. So we like what that's doing there. The other part too, is we just have to keep more of our customers. So even though retention was up quarter-to-quarter in most of those others states, we still would like it to be higher. It's improving, but the overall number will continue to be challenged by the efforts in New York and Florida. As Joe just pointed out, we know how to make money. We know how to get a combined ratio down. That team's working hard on doing that. And if that means that we give out more growth in those states, then we garner in the other states -- we look at each state as its own battleground, a place we want to pick up market share, but we're not going to lose in one market, so we can make ourselves feel like we're winning in total.

Joshua David Shanker
Deutsche Bank AG, Research Division

Can I make any intuitions about there being a trend change going on, or is it premature?

Thomas J. Wilson
Chairman & CEO

I think it's a little early to tell. I think you can say in the other states we're growing rapidly and we're -- so I think if you just look at -- I would tell you, our business model is working. It's going after the personal touch, the advertising we're doing, we know how to run a good combined ratio in auto, I'm not worried about that. We've got a few places we have to fix, I think you would draw that conclusion. Drawing a conclusion or trying to make a forecast on sales and retention, while, not as difficult as catastrophes is also a little bit...

Joshua David Shanker
Deutsche Bank AG, Research Division

And then my second question, you guys have certainly exhausted this in Q.A. In the way it shows up in the numbers, it would appear as if the frequency uptick, particularly, I guess, New York and Florida came suddenly in terms of the way it hits the P&L. Maybe, I'm not really understanding how these books, but I understand this has been a developing issue. But the rise is very sudden the way it hits the numbers, how can I reconcile that?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

I would say that the number continued to accelerate throughout the year.

Joshua David Shanker
Deutsche Bank AG, Research Division

And particularly in the fourth quarter?

Thomas J. Wilson
Chairman & CEO

You get two things going on there. One, particularly, when you look in the sequential quarters. There is a seasonality effect, and if you go back to the bottom right corner of Page 5, you can see that pattern of fourth quarter's being higher for a long period of time. So that's a big chunk of it. There is a second piece of it that some of these trends were accelerating over the course of the year. There've been some fee schedule changes in New York. There've been things that are accelerating that issue. So a little bit of what was going on in the quarter was maybe a catch up as we digested those from the previous quarters. So it's a combination of all of those. The biggest piece of it is seasonality, and then the next piece is the continuation of those trends.

Operator

Our final question is from Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

First one, Don, is it possible to find what the pension expense figure was for 2010, and what you expect it to be in 2011?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

I could tell what it was in 2010. It's about $350 million.

Brian Robert Meredith
UBS Investment Bank, Research Division

And most companies are saying that, that's going to probably be down in 2011. Would you expect it to be similar for you all?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

I'm not going to tell you what we expect yet for 2011.

Brian Robert Meredith
UBS Investment Bank, Research Division

And then the second question, just curious, the Arizona loss. Just looking at the industry loss statistics that are out there right now, it looks like an awfully large number for you all relative to what the industry is reporting. I'm wondering if there's anything unusual with that loss, if you have concentration issues in Arizona, your policy's more generous, something like that, that possibly happened?

Thomas J. Wilson
Chairman & CEO

Here's what we're seeing on it, Brian. It is a little bit different. The storm happened, we have a normal pattern of reported losses that comes in, and you get a lot right after the storm, and then there's sort of a decay rate, that runs through there and it declines. We actually saw that normal pattern running through and then all of a sudden it popped. It went back up, and now it's starting the decay rate again. Arizona has a unique law on how long somebody -- a waiting period on when new contractors come into the state and get licensed before they can start actually work in business. So we got a bunch of roofers come into the state, get licensed. They're going door to door knocking on peoples doors saying, "Can I get on your roof?" That's accelerating the claims. And almost to the day, we saw what would have been the expiration of that waiting period. We saw a spike in claim volumes come up right after that. It came up late in the year, actually after the turn of the year, so we went back and have reacted quickly to what we were seeing in those underlying numbers to get that cost rolled through our fourth quarter. So I think that's some of it.

Brian Robert Meredith
UBS Investment Bank, Research Division

Hit ratios on new issue apps [indiscernible] coming in, how has that been turning on a year-over-year basis?

Thomas J. Wilson
Chairman & CEO

What do you mean by...

Brian Robert Meredith
UBS Investment Bank, Research Division

I mean, are you actually binding it?

Thomas J. Wilson
Chairman & CEO

Oh, close ratios.

Brian Robert Meredith
UBS Investment Bank, Research Division

Close ratios. I'm sorry, hit ratios. My apologies.

Thomas J. Wilson
Chairman & CEO

That's a tale of 50 states. So I wouldn't -- we still like where we're positioned competitively. If we don't like where we are, we restructure the rates, open new companies, do all the things we do. So there's nothing really to do in terms of -- nothing major there in terms of forecast. Let me summarize. We had good progress in executing our strategy this year. We do have the financial capability and wherewithal to do what we want to do which is to both grow our business and give a good return for shareholders. Our goals this year are obviously to improve our operating results by getting customer loyalty up by lowering their combined ratio and raising investment income although that has to be adjusted for volumes, because the balance sheet gets small. We need to grow our businesses profitably and then differentiate ourselves from the competition by serving the unique needs of each customer. So thank you, all. We'll see you all next quarter.

Operator
Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now disconnect. Have a good day.