S&P Global
Market Intelligence

The Allstate Corporation NYSE:ALL

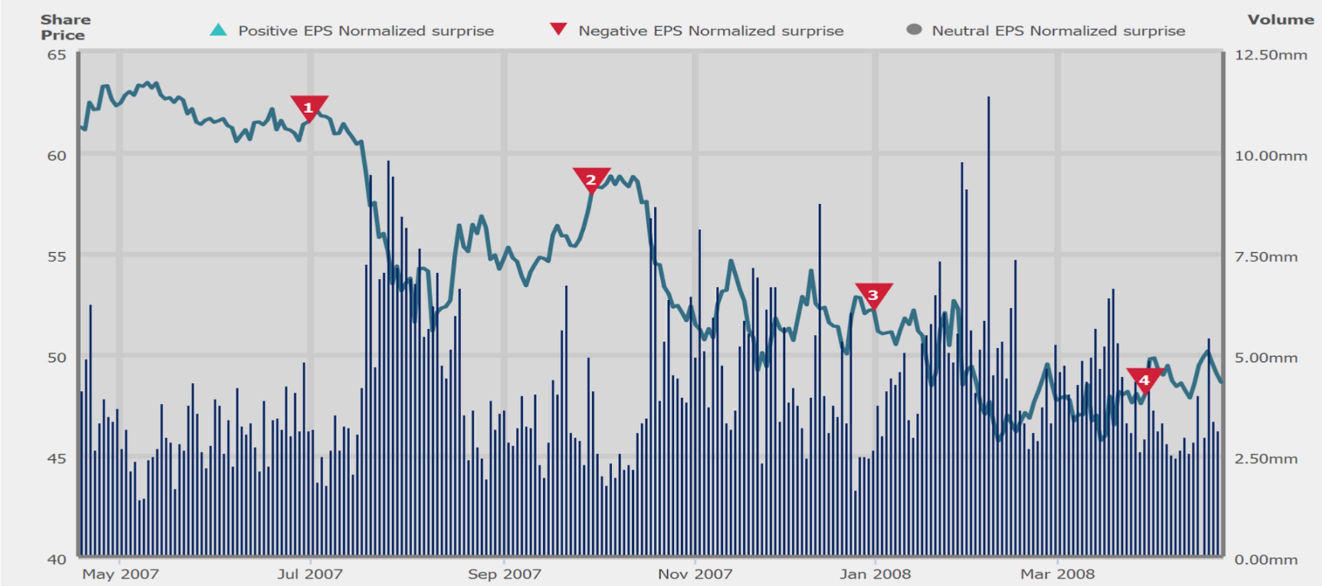
FQ2 2008 Earnings Call Transcripts

Thursday, July 24, 2008 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2008-			-FQ3 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.30	1.24	(4.62 %)	1.32	5.52	6.03
Revenue	-	-	(0.86 %)	-	-	-
Revenue (mm)	6808.48	6750.00	-	6778.47	26984.88	27036.80

Currency: USD
Consensus as of Jul-24-2008 1:34 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2007	1.80	1.76	1 (2.22 %)
FQ3 2007	1.70	1.54	2 (9.41 %)
FQ4 2007	1.32	1.28	3 (3.03 %)
FQ1 2008	1.62	1.33	4 (17.90 %)

Table of Contents

Call Participants

EXECUTIVES

Eric A. Simonson

George E. Ruebenson

James E. Hohmann

Robert L. Block

Samuel H. Pilch

Thomas J. Wilson

ANALYSTS

Brian Meredith
UBS

Dan Johnson
Citadel Investment Group

David Lewis
Raymond James & Associates

David Small
JPMorgan

Gary Ransom
Fox-Pitt Kelton

Jay Cohen
Merrill Lynch

Jay Gelb
Lehman Brothers

Joshua Shanker
Citigroup

Matthew Heimermann
JPMorgan

Meyer Shields
Stifel Nicolaus

Paul Newsome
Sandler O'Neill's

Thomas Cholnoky
Goldman Sachs

Vinay Misquith
Credit Suisse

William Wilt
Morgan Stanley

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Allstate Corporation Second Quarter 2008 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later we'll conduct a question-and-answer session and instructions will be given at that time. [Operator Instructions]. As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference, Mr. Robert Block, Vice President of Investor Relations. Sir, you may begin.

Robert L. Block

Thanks, Matt. Good morning, and thanks for joining us today. Last night we released our press release detailing our financial results for the second quarter 2008, as well as the majority of our investor supplement and importantly, an update of our reinsurance program. All of these documents are available on the Investor Relations portion of the Allstate website.

With me today are, Tom Wilson, Sam Pilch, Jim Hohmann, George Ruebenson and Ric Simonson. After some prepared remarks, we'll hold a Q & A session. We do ask that you limit yourself to one question and one follow-up, so that we can accommodate as many inquiries as our time will allow.

Note that the following discussion may contain forward-looking statements regarding all statements operations. Actual results may differ materially. For information on factors that could cause such differences refer to our 2007 Form 10-K, the first quarter 2008 Form 10-Q and yesterday's press release. We may discuss certain non-GAAP measures for which you will find reconciliations in the press release and investor supplements on allstate.com.

This call is being regarded and your participation will constitute consent to any recording, publication, webcast, broadcast of your name, voice, and comments by Allstate. If you don't agree with these conditions, please disconnect now. A replay will be available shortly following the conclusion of the call. Our remarks are current only as of the time and date of this call. Finally, investor relations will be available to answer inquiries after the call has ended.

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

Thomas J. Wilson

Good morning. As always, we appreciate your interest in our company and your participation on the call. There are four key messages you should take away from the second quarter results.

First, we are exceeding our underlying combined ratio of goals in our property-casualty operations. Secondly, this strengthen enabled us to cover a record level of catastrophe losses. Thirdly, we are proactively and decisively managing our high quality investment portfolio to mitigate risk and optimize returns. And lastly, we continue to execute our strategy to reinvent protection and retirement for the consumer, despite a turbulent external environment.

I will begin with few comments on the overall quarter. Bob will cover the results for Allstate Protection. Sam will comment on Allstate's financial investments and capital. And then, we'll have plenty of time for dialogue.

Operating income for the second quarter was $683 million, a $389 million decline from last year's second quarter. The decline was almost entirely due to the increased level of catastrophe losses and the lack of favorable reserve re-estimates in the quarter. Catastrophe losses for the quarter as measured on a percent earned premium basis were at record levels for the second quarter.

Our underlying combined ratio, excluding catastrophes and prior year reserve re-estimates was 84.1, which reflects our plan to achieve combined ratio targets even if we had to give up growth. That was a good choice, since it enabled us to cover both the catastrophe losses and a shift in valuation accounting on our investment portfolio.

Allstate Financial's results were heavily impacted by the capital markets. Operating income was $118 million which was down, due to a decline in investment spreads and increased non-deferred expenses. We chose to lower our risk profile early in the year, by raising liquidity and increasing the portion of our portfolio subject to short-term interest rates, both of which negatively impacted results. We did generate good returns on our fixed annuity sales in the quarter, but we still have work to do to make this a consistently high performing business.

We also continue to aggressively manage our investment portfolio in light of continued weak and volatile financial markets. As you know, our $113 billion investment portfolio is highly diversified, it's primarily fixed income securities and 95% of those are investment grade credits, and the portfolio generated $1.4 billion in investment income, which was down as a result of the lower short-term rates and reduced income from our limited partnerships.

Despite that strong position, we are expanding our risk mitigation and return optimization programs, given our economic and financial market outlook. Our strategy is to cut off the tails for the possible loss distribution through portfolio hedges and opportunistically decrease our exposure to real estate and financial credit. The portfolio hedges are primarily focused on interest rates and equity valuations.

We are only doing a small risk reduction in credit spreads given the volatility and ineffectiveness of derivatives in this area. We also further expanded our ongoing portfolio of management activity and identified specific investments that could be significantly impacted by additional deterioration, either financial markets or underlying assets.

And we've changed our intent, so that we may not hold those securities to maturity. The net result of both of those is a small reduction in operating income run rate, and a shift in the accounting of unrealized investment losses to realized losses. As always, we believe in taking decisive action based on a thorough analytical review and the strong capabilities resident within our company.

And while this resulted in a significant reduction in second quarter net income, it had minimal impact on shareholders' equity since these investments were already carried at fair value, and Sam will talk more about that in detail.

Let me comment on our acquisition philosophy, since there have been several recent articles linking Allstate to the proposed sale of RBS Insurance. First, acquisitions have been and will continue to be an option to create shareholder value.

Our criteria, pretty straightforward and haven't changed, it has to be a business that's related to that which we do well and supports our strategy. We prefer to purchase good businesses rather than troubled or mismanaged operations and the price and financing must be attractive for our shareholders.

We recently closed on the acquisition of the Partnership Marketing Group from GE, which met all of those criteria. It will double the size of our Motor Club business and gives us entry into the wholesale partnership segment of that service. As to future acquisitions, we give them full consideration if they meet our criteria. But we do not comment on specific transactions or rumors.

With that, let me turn it back over to Bob.

Robert L. Block

Thanks, Tom. Let me quickly go through the results for Allstate Protection. In a nutshell, the strong performance in the second quarter reflects continuation of our disciplined philosophy of profitable growth.

Beginning with the top line, overall net written premium declined 2% from the second quarter of 2007, a result consistent with recent trends. Allstate standard auto and homeowners results were comparable with the prior year quarter, while Encompass fell by 11.3%, primarily due to the discontinuation of one large account. In general, new business trends for auto and homeowners insurance remained soft.

Competition remains tough, but disciplined, and the weaker economy represented by lower car and home sales reduces the opportunity for new sales. Retentions continue to fall slightly but remain at solid levels and average premiums are increasing slightly, as approved price changes are being reflected in the trends. Going forward we will remain focused on generating profitable growth.

Looking at the underwriting results, our combined ratio of 94.4% mirrored our experience in the first quarter of the year and represented an increase from the second quarter of 2007 to 6.8 points. Increased catastrophe losses and the lack of favorable reserve re-estimates in the second quarter, drove the entire increase as our underlying combined ratio remained level with prior year at a very healthy 84.1%.

With six months now behind us, we are improving our outlook for the entire year in regards to the underlying combined ratio lowering the range to 86% to 88% from 87% to 89%. Looking at the trends in loss cost by-lines, auto frequencies continued to contribute favorably, bodily injury frequency fell 7.6% compared to last year and property damage dropped 4.2%.

There is much speculation as to how much influence miles driven and/or inflated gas prices have on these trends. And if the favorable trends will last, I won't add to that speculation. But we'll say that we are constantly monitoring these trends in order to be able to respond to any shifts that we may detect. Auto severities followed a similar pattern established over the last several quarters bodily injury severity rose 7.1% in the quarter, while property damage rose a modest 2.6%.

Inflationary pressures on injury costs are being offset to some extent by more modest pressures on the physical damage coverages. When you look at the total auto loss cost trends, they remain manageable and within our pricing parameters.

For homeowners the loss cost trends remained elevated, this quarter saw a non-catastrophe frequency jump 13.7% heavily influenced by the weather. Paid severity, on the other hand rose only 0.3% balancing out the large increase in frequency. The underlying margins remain comparable, with the margins posted in the second quarter of 2007. The biggest story in the quarter was the weather.

We experienced a record level of catastrophe losses for a second quarter $698 million, resulting from 43 events based on our definition of a catastrophe. While the amount of loss was more than most analysts expected, it does appear to be in line with recently released estimates for industry losses in the quarter. We added a breakdown by type of catastrophe in our press release for your information.

The important thing to remember is that, we generated underwriting profits despite the record levels of catastrophes, validating our disciplined approach to pricing and margin management over the long run.

With that, let's hear from Sam Pilch.

Samuel H. Pilch

Thank you, Bob. I like to begin with a brief summary of Allstate Financial's operation. After that, I'll spend most of my time reviewing our investments.

Allstate Financial's premiums and deposits increased 54% to $4.5 billion, primarily due to $2.5 billion issuance of institutional products and $1.3 billion of deposits on fixed deferred annuities, or a 58% increase. Operating income declined $36 million to $118 million due to lower investment spread and increased operating expenses, due to growth and investments in innovation initiatives to reinvent retirement for customers; partially offset by lower amortization of DAC and higher benefit spread.

Lower investment spreads resulted from lower net investment income, due to lower investment yields on floating rate assets, higher short-term investment balances and lower investment balances, reflecting the effects of prior year dividends. Higher short-term balances reflect actions taken to offset liquidity in some asset classes and the expected retirement of $3.1 billion of institutional markets extendable funding agreements in 2008 and the first quarter of 2009.

Benefit spread increased which continues to be sustained by our profitable life insurance business. These operating income trends are expected to continue with operating income remaining at a level of 65% to 75% of recent previous periods.

Turning to our investment performance, as you may recall from previous discussions, for property-liability, we focus on after-tax returns which has led to a high level of municipal bonds and liquidity, which has led to holdings of equity securities and public debt including corporate bonds.

At Allstate Financial, we follow asset liability management focused on the need for risk adjusted spreads weighting to a selection of assets that perform favorably on a long-term basis. We carry most of our assets at fair value but not our liabilities. As a result, the volatility experience and unrealized gain and losses on investments, is not offset with corresponding changes and fair value of the liabilities.

As of the end of the second quarter, our investment portfolios totaled $114 billion which was $1.9 billion or 1.6% less than the end of the first quarter. The decline was related to lower valuations of our fixed income portfolio. Our net unrealized capital loss position at June 30 was approximately $789 million, compared to a net unrealized capital loss of $570 million at the end of the first quarter, for a net increase on unrealized capital losses of $219 million, primarily in our fixed income portfolio.

The change in the fixed income unrealized capital loss position was primarily attributable to investment grade, fixed income securities, as the yields supporting fair values increased from higher risk free interest rates, partly offset by narrowing credit spreads.

As Tom described, during the quarter we further expanded our risk mitigation and return optimization programs and developed additional programs in response to an altered outlook for a continued weakness in US financial markets and economy, including continued volatility in the financial markets, continued reduced liquidity in certain asset classes and further unfavorable economic trends.

We have begun to implement the macro-hedging program, during the third quarter using derivatives to partially mitigate the potential adverse impacts for potential future increases in interest rates, increases in credit spreads and negative equity market valuations. The interest rate component is being integrated with our current program to protect a certain portion of our fixed income securities if interest rates increase above a targeted maximum level, for example, in excess of 150 basis points.

The equity hedge will be designed to protect the equity portfolio from significant equity market valuation declines below a targeted level using a collar whereby we give up returns above a certain level. For example, if equity market valuations decline below 25% the equity hedge protects valuations and with a collar we give up the returns in excess of 20%.

Another component of the macro-hedging program is less comprehensive and these derivatives are less effective and efficient and partially mitigate the municipal bond rate risk and some general market credit risk. The cost of the macro-hedge program for one year is currently estimated to be approximately $85 million. The provisions of the macro-hedge program and its estimated cost will be dependent upon market conditions at the time of entering into the applicable contract.

A comprehensive review identified specific investments that could be significantly impacted by continued deterioration in the economy, including a portion of our residential and commercial real estate securities collateralized by residential and commercial mortgage loans, mortgage loans and securities issued by financial institutions.

As a result of the decision to reduce our exposure in these investments, we have changed in intent write-downs on investments with a fair value of approximately $3.3 billion at June 30, with approximately $857 million of realized capital losses recognized in the second quarter net income with minimal net impact on shareholders equity as these investments were carried at fair value with unrealized loss at March 31.

Any funds raised from the eventual dispositions of investments will be reinvested in accordance with asset liability management strategies and the initial stage of our enhanced enterprise wide asset allocation strategy. We will report on our progress of our risk mitigation and return optimization programs, when we publish third quarter results.

The last area, I will cover on investments is our net investment income and our realized capital gains and loss results. Net invested income was $1.4 billion, a decline of 13.6% compared to the second quarter of last year. Lower net investment income for both businesses was driven by decreased income on limited partnerships. Income from limited partnership interest decreased $56 million to $30 million for the second quarter of 2008, versus $86 million for the same quarter in 2007. The decline was primarily related to real estate and hedge funds as capital market deleveraging has slowed the pace at which portfolio holdings are being sold.

Income earned on these types of investments, partnership investments, tend to be lumpy, so this is not unexpected. Net realized capital losses for the quarter were $1.2 billion, on a pre-tax basis and included $1.1 billion of net losses related to dispositions, nearly all from change in intent write-downs and $250 million of impairment write-downs partially offset by net capital gains of $123 million on derivatives and equity trading.

The $1.1 billion of losses from dispositions primarily comprise change in intent write-downs. $857million are related to our risk mitigation and return optimization program, and $229 million relate to asset allocation and specific securities. All securities subject to intent write-downs and 97% of the fixed income securities subject to impairment write-downs are performing in accordance with contractual cash flows.

We received cash flows of $76 million in the quarter from securities subject to impairment write-downs. Impairment write-downs included $205 million from fixed income securities primarily related to residential mortgages and other structured securities and $37 million for equity securities.

Derivative instruments recorded a net $123 million realized capital gain primarily related to increasing interest rates from the risk reduction programs for duration management and hedges of realized gains on equity securities, which increased in value as equity prices declined.

Now I will wrap up with a few additional comments on capital management actions and related balance sheet metrics.

In the area of capital management actions, during the quarter, we repurchased 8.8 million shares for $434 million. There is $1.4 billion remaining on the $2 billion share repurchase program that is expected to be completed by the end of the first quarter of 2009. Earlier this week, we declared a $0.40 dividend… $0.41 dividend, or 7.9% increase that we began paying with our first quarter dividend.

We continue to hold $2.8 billion of investments at the Allcorp level. Our book value at the end of the second quarter was $35.93 per share, comparable to the $36.39 per share reported in the second quarter of the previous year. Excluding unrealized net capital gains and fixed income securities, book value increased by $1.23 or 3.4%.

Operating income return on equity for the 12 months ended June 30, was 15.1%, fueled by the earnings power of our property-liability operations. Our financial position and performance continue to be very strong and positions us very well to take advantage of new opportunities.

Turning back now to Tom.

Thomas J. Wilson

Okay. I think we are ready to do the question-and-answers.

Robert L. Block

Matt, if you would start the Q&A session.
QUESTION AND ANSWER

Question and Answer

Operator

[Operator Instructions]. Our first question is from David Lewis of Raymond James. Sir, your question please.

David Lewis
Raymond James & Associates

Thank you, and good morning.

Thomas J. Wilson

Good morning.

David Lewis
Raymond James & Associates

Can you talk a little bit about the competitive environment for standard auto? Is it continuing to maybe loosen up a little bit as some underwriting pressures continue for the industry and can you give us a data point of how many state rate increases you maybe saw in the first quarter? Clearly, the new issued applications declined only 6.7% versus a 13.7% in the first quarter. So, I assume you are seeing some favorable trends there continuing?

Thomas J. Wilson

David, I will make a couple comments about the overall market and George, can give you some specifics on rate changes. In terms of the overall market, I think you'll continue to see trends in standard auto… the trend line was like it was last year. Last year first half of the year was very competitive, a lot of rate decreases by primarily State Farm, Progressive and GEICO.

That kind of backed off as you got into the second half of last year. That has continued to back off, so that if you look at the top 10 companies in the marketplace this year, there are about four times as many increases as there are decreases. If you look at some published statistics, on public stuff, that was at that average prices are up about 1%.

You can look at our average premium, it is up 1.4% which says from our standpoint the market is coming back to where we are, which is a strategy of small and consistent, adjust your pricing as you need to. Don't get into trying to buy business by cutting your price. George, you want to talk about what you are doing in rate increases?

George E. Ruebenson

Yes, what we are doing with rate increases is, where we see the necessity to preserve the margin we are taking those increases. One of the reasons that we think that, the guidance or the outlook can be changed from 87 to 89 to 86 to 88 is we have been diligent and very disciplined in our approach to it. We have not chased growth like some of our competitors have. We are still very competitive in the more profitable high IS scores.

But I would like to reinforce the fact that we compete on many other dimensions besides just price. We now have Your Choice Auto in I think 83% of the country, California is the newest addition to it. We've got good reception by the marketplace in that. We have 3.9 million policies we have issued, about 2.5 million new and 1.4 million on renewal. We have a very disciplined approach to our retention programs.

We have introduced Allstate Blue, which is our non-standard product we're getting a good lift in the marketplace from that. So, price is an important factor in consumers' decisions. The weakening economy makes it even more important, but we compete on many other dimensions besides that.

David Lewis

Raymond James & Associates

George, do you anticipate that you might see, the competitive pressures loosen a little bit in the second half as you saw last year?

George E. Ruebenson

I think it's possible the one thing I do not know is with declining accident rates, whether competitors will continue to take the increases that they have in the first half of the year. I simply don't know that. What I do know is their reported margins are considerably worse than ours. So, I would imagine they have to continue to take some kind of rate increases.

David Lewis
Raymond James & Associates

Thank you very much.

Operator

Our next question is from Tom Cholnoky of Goldman Sachs. Your question, please.

Thomas Cholnoky
Goldman Sachs

Good morning, Tom. I guess I have to ask a guidance question. You are running an underlying combined ratio of around just under 85% through six months. You are talking about loss cost trends that are relatively stable. If you take the midpoint of your guidance range it would imply to get to that midpoint of the year, the second half would have to run almost four points higher than the first half. So, I'm trying to understand or reconcile what I should read into that guidance?

Thomas J. Wilson

Good morning, Tom. I think what you should read into the guidance, is we feel good about the business. We feel good about our trends and profitability and we feel better today than we did six months ago. As to the specifics, we try to give you direction. We try to have it be a couple point spread we try to have it be whole numbers. We don't try to give people numbers, they can plug into the model. We moved away from that strategy a couple years ago.

So, it is… if you look at the second half of last year, we did have some bump last year, in the second half of last year in the combined ratio, which was driven by frequency. While we are confident and like where we are in frequency, today we like the trends that we see in the first half of the year. We reflect on it and do not think it is only just gas prices and miles driven. We think there is a whole bunch of other things that go into that including statistical volatility, which nobody can predict. So, we give you a number, we think we can make.

Thomas Cholnoky
Goldman Sachs

Okay. I guess if I can follow-up --

Thomas J. Wilson

You get a follow-up. Go ahead.

Thomas Cholnoky
Goldman Sachs

Thank you. I will change the topic. Can you talk a little bit about… I guess one of the things that I, obviously, you lost a decision in California on your homeowners. I'm wondering if you can talk to that a little bit in terms of that, and the potential for backlash in other states given the fact that the economy continues to be weak and whether you could face further pressures elsewhere in the country given the profitability of the overall personal lines business?

Thomas J. Wilson

Let me ask George to do that, but maybe George comment not just on homeowners, which is the most recent one, but talk about auto as well.

George E. Ruebenson

Yes, Tom, actually there were two things that happened to us in California. First, was an auto rate decrease that was mandated of 15.9% at the end of April, and then recently we had the homeowner rate decrease of 28% at the end of July. The impact on profitability of the auto reduction will be about $90 million this year and about $20 million for homeowners, so a little over $100 million in '08. But these reductions were considered in the revised outlook of 86 to 88. What we are trying to do is, work with the department to improve the situation.

We have recently filed an auto rate increase in California, the department has not ruled on it. I think they just started to review it. We have rolled out, as I mentioned a minute ago, Your Choice Auto. In October… which we are rolling it out in October. We are evaluating all of our options in homeowners. But I would like to remind that you we stopped writing homeowners new business in July of last year, but it is still our intent to provide quality coverage to our renewal book at a good price, and earn an acceptable return.

And I was personally was out meeting with the Commissioner a few weeks ago to see if we could work out a more amicable solution to some of these problems. Exactly what will happen, obviously, I can't comment on that.

Thomas Cholnoky
Goldman Sachs

What about the backlash in other states?

George E. Ruebenson

Well, we just settled. In Texas, for example, which is always a difficult state for us; a real small rate decrease of about 3%. I think it is somewhere in the neighborhood of $15 million. Florida, we are working with the Department on a resolution of our dispute there. As of right now, we do not have any other major states that are talking about any kind of big rate decreases.

Thomas Cholnoky
Goldman Sachs

Okay, great. Thank you.

Operator

Our next question is from Jay Gelb of Lehman Brothers. Your question, please.

Jay Gelb
Lehman Brothers

Thanks. Good morning. On the auto frequency trend, to what extent do you think competitors might start pricing that in if they feel it is sustainable for a while based in part on higher gas trends, lower or worse employment trends, and things like that?

Thomas J. Wilson

Good morning, Jay. It is Tom. We can never tell what other people will do in terms of pricing. What we can tell you is what we do, which is we price that which we have, not which we hope for. If you look at the long-term trend, of course, it has been down but we don't price for a long-term trend. It has been down as you point out for a whole bunch of reasons, more cars per household, older drivers, safer cars, better drunk driving laws.

So there are a number of things which have been driving it down. You will remember that it was down pretty substantially in ' 06. I think we were down about 3% in '06 from '05. Then in '07 it went back up.

Last year it went up by 3.6%, which kind of kept it flat with where we were in '05 and '04. This year, we are down 2.5% for the first half, a lot of which was driven by a 4.6% decline in this quarter. Some of that could be due to fewer miles, but, our analysis shows there is a whole bunch of other things that get factored in here.

Besides the long-term trends I talked about, there is, and there is some short-term things like miles driven. But there is also weather, there's also just statistical volatility. So, I can't tell you whether other people will price it in. I do know what they have been doing, which is raising prices more than lowering prices. And I can tell you what we will do is, we continue to work to take small increases when we need them, reflecting on the trends and price on what we have, not what we or regulators hope will be. Does that help?

Jay Gelb
Lehman Brothers

It does. Thank you. And then, on a separate topic. On Allstate Financial, clearly there was some margin pressure there in the quarter first. Were there any one-time issues there, and we might want to think about backing out on projecting going to forward, and if not, is there any potential there for recovery in linked quarter profits as the year goes on?

Thomas J. Wilson

As always in every quarter, there is lot's of pluses and minuses, and sometimes I think a variance analysis is done just, so we can get to the number. So those things that go up and down whether that is stake or favorable, legal settlements or unfavorable settlements, I would say the big thing to focus on here, Jay is that, investment spreads were down. That was driven by a couple of things.

One, if you look at our short-term assets in total, they are up to $9 billion, which was about $6 billion higher than the end of last year. Of that $9 billion, almost $6 billion of it sits in Allstate Financial, and we did that for a couple of reasons. One is, we had a large block of institutional market liabilities coming due this year. And we wanted to make sure we had the cash to pay those off, and we are going to have to sell assets into the marketplace that we didn't want to have to sell into.

Secondly, we reduced we put more securities into short-term interest rate securities last year for some asset liability management stuff because we didn't like what was happening to duration, and of course short-term rates came way down. So that clipped them. I think Jim is looking at repositioning some of those things as we go forward. I don't think it will bring it back to the level of income that we saw throughout last year by quarter. Jim, does that seem fair to you?

James E. Hohmann

That's correct. The short-term you are talking about there was a significant block of floating in there. And we have already started to reposition there.

Thomas J. Wilson

So, you will see it come back some, but not completely.

Jay Gelb
Lehman Brothers

Okay. That's helpful. Thanks.

Thomas J. Wilson

Jay, the other thing to focus on in, if you are interested in the details and how it works, Bob can take you through it, but, there is what I like to call in Allstate Financial, there is the miss to coffee for accounting, which is you pour all the stuff into the top and that coffee just kind of drips out over time.

And so, given the reduction in the capital losses, you will see a bunch of changes in how DAC is going through over the next couple years which is one of the reasons Sam talked about that we are expecting this to be 65% to 75% of where we have been in the past, because all those realized capital gains, actually some of that raises deferred acquisition costs, and then we have to expense those as we go forward from here.

So there is a bunch of moving pieces. Bob can take you through the specifics if you want.

Jay Gelb
Lehman Brothers

I appreciate it. Thank you.

Operator

Our next question is from Dan Johnson of Citadel. Your question, please.

Dan Johnson
Citadel Investment Group

Great. Thank you very much. Investment related questions focusing on the CMBS. There was some comments about your desire to maybe insulate the corporation from more adverse potential developments in those marketplaces. Can you talk a little bit about what you are seeing specifically within the CMBS market that gives you a bit of caution?

And then on a macro investment basis, when you look at the yields that you are producing now, call it in the high 4s, I believe, in the Protection segment, how do you see that trending, not only as a result of market conditions but also as a result of some of the changes you are making that you announced today?

Thomas J. Wilson

I will let Ric make some comments about the CMBS market. Let me go back to some of the logic, Dan, on what our outlook is on the economy, and what we are trying to do with our macro program. So, the portfolio hedge is pretty straightforward. We want to protect the value of our portfolio if interest rates take a sharp and sudden spike up.

If you look at the change in realized gains or losses, most of it happens to do with interest rates, and credit spreads, not actually credit impacts. A lot of conversation is always around the credit, but really the biggest driver of the swings in unrealized gains and losses are those two macro things. So, one of the things we try to do in that program is try to dampen that with what we are doing.

We always crawl through every investment. We are good at individual assets. We own lots of small pieces of everything, but we looked hard at those assets that might have further deterioration including real estate and the financial services sector, and decided to lighten our load if we could at a good price. We don't have to give the stuff away. It is paying interest.

We like it, but we said, as we look forward, from a risk mitigation standpoint, we would like to have less ownership in those categories. So that's what led us to the whole program. Ric can talk specifically about CMBS

Eric A. Simonson

Good morning, Dan. We have been actually at this reduction of risk exposure in both residential and commercial related real estate securities for a while. We aren't in a position to move commercial mortgage whole loans around. But, we are in a position to move CMBS which at times is a proxy for origination cycles and whole loans. The '06, '07 vintages of CMBS have been the most volatile, in terms of spreads. Spreads have been extremely up and down over the last six to eight months.

In periods of relative market strength, we have been trimming that exposure. Commercial real estate has been linked, I think, unfairly to the problems in residential real estate. There are connections, when unemployment gets to a high enough level that's going to bring commercial real estate closer to its knees than it is today, but, in fact today commercial real estate is actually doing quite well.

So, this has been kind of an anticipatory prophylactic approach to total real estate related exposure and CMBS, as a relatively more liquid form of real estate is something that we were able to focus on.

Thomas J. Wilson

Dan, in the, and I recognize the press release just went out. But, if we go to page 33 in the press release and you want to look at the specific weightings we have by category, of the $3.3 billion we said we might want to sell this stuff, you will see about 25% of it is financial service sector exposure. About 25% is RMBS. You get about 10% each between commercial real estate exposure or other, like all-day securities, and the CMBS piece is really less than 10%.

So there is a schedule in there which details both the, what we are looking at and what the impact was on fair value, which gets to Ric's point of, sort of how you look at it in total. That is one where it is a little more volatile.

Dan Johnson
Citadel Investment Group

Great. I will follow-up later. Just, maybe a thought on the yield outlook overall? Thank you.

Thomas J. Wilson

I think if you look at our yield as a gross, we hold most of our securities. So, it doesn't change a lot from quarter to quarter. So, we are not out. We do have some things like as we talked about in Allstate Financial with managing liquidity which impacts yield. Sorry, as we move this stuff into tax exempt, the yield will be lower.

But the after-tax return we still think will be economic, and is in line with the stuff we talked about before in terms of enterprise asset allocation in terms of creating additional extra total return from the portfolio.

Dan Johnson
Citadel Investment Group

Thank you very much.

Operator

Our next question is from Matthew Heimermann of JPMorgan. Your question, please.

Matthew Heimermann
JPMorgan

Good morning, everybody. A couple quick numbers questions if I could, and then I had a bigger question. The expense ratio in the quarter, was there anything unusual affecting that like bonus accrual or anything else? It just seemed to be kind of different than we've seen in the past.

Thomas J. Wilson

Matt, what do you mean different as in lower?

Matthew Heimermann
JPMorgan

Much lower, yeah.

Thomas J. Wilson

Yeah, there is always some accruals that run through there. We had some sales conference accruals. We had some settlements, lower management incentives because profit is down. So there is a bunch of stuff rattling through there. I think the message I would leave you with is, we're always working hard to manage expenses. It's of course, keeping the ratio down when we have inflation or even modest inflation, when your premiums are flat to down, it's a little bit of a trick, we worked hard at that.

Remember, a year and a half or two years ago we reduced headcount in the home office by 850 people. This year we had a program which we're successfully executing to reduce technology expenses through an 80/20 prioritization. So we continue to shift resources around the world to get low costs. So we continue to work hard at it. I don't think you should expect to see major decreases in it, nor major increases in it from oil rads today.

Matthew Heimermann
JPMorgan

Okay. And then, this is a bit of a nit-picky, but your investment expense number if you look at 43 of your supplement has been trending down quite dramatically. And I wondered if there was, what was driving that? Whether that was a function of the environment we're in or change in mandates or really what was going on there?

Eric A. Simonson

It is a great nit question, this is Ric. And it's a function of reduced activity in securities lending. The way the accounting works, we have to attribute to investment expense, the implied borrowing cost associated with security lending on the reinvestment of the cash though. That's all is going on there. I wish my investment expenses -- my real expenses were declining but they are not.

Thomas J. Wilson

We are hoping Wall Street wants to reduce its margin.

Matthew Heimermann
JPMorgan

You might get it. I guess the last question was just -- I'll try to make this as general as possible but, there has been a lot of acquisition activity in the industry. There is a lot of assets for sale. I guess what metrics internally would you use to judge the merits of any type of acquisition you might consider? And guess are there any constraints in terms of size, geography, culture, things like that that would keep you from participating?

Thomas J. Wilson

I mean, obviously, all those things. There are boundaries on every decision criteria. All of those are decision criteria. So if -- but I would go back to sort of what criteria. When we look at these businesses, okay, it has to be a business we know and are good at, and feel good about the prospects for. It should be linked to our strategy.

So, there is obviously limits but I don't, I wouldn't -- nothing that -- limits vary by deal and in some deals it's more important on cultural fit, some deals the price is more important. I can just say you can just look at what we've done and we try to be prudent and balanced about what we do.

But we do think acquisitions are ways that companies of our skills and capabilities could ensure growth. So, we look at just about everything and we just did the Partnership Marketing Group, and we like that deal. Other than that, I wouldn't go to any place else.

Matthew Heimermann
JPMorgan

To the partnership deal, I guess historically when you look at your acquisitions, they've been very focused on either expanding the distribution or scale within your existing business and kind of footprint. It's not still kind of the priority?

Thomas J. Wilson

Well, our strategy is reinvent protection retirement for the consumer. The businesses we're in, we are good at auto insurance, we're good at homeowners insurance we're good at other kinds of insurances. We started to add some other services to that. We're good in the life insurance business.

We are getting a lot better in fixed annuities. I wouldn't, if you said to me, do I fell like we are good enough at fixed annuities to go out and buy a fixed annuity company today, I would say no. Do I think we could in the future? Sure. So, I don't -- if you are trying to poke around in terms of RBS, I'm not going to go there.

Matthew Heimermann
JPMorgan

No, just curious. I mean we just don't really have any -- you've never really laid out I guess historically, financial metrics or other things you might -- for us externally to use as a guide to sanity check anything that you do.

Thomas J. Wilson

Okay.

Matthew Heimermann
JPMorgan

So that's kind of the basis.

Thomas J. Wilson

Okay, yeah. Because we'll think about that but they all sort of be one-off. There are some that might even meet metrics we would give you that we would choose not to do. And I would point out those are recent large transaction which could have possibly met people's trends, metrics, and we chose not to do it.

Matthew Heimermann
JPMorgan

Fair enough, all right. Thanks, Tom.

Operator

Our next question is from Brian Meredith of UBS. Your question, please.

Brian Meredith
UBS

Good morning, Tom.

Thomas J. Wilson

Hi, Brian.

Brian Meredith
UBS

Couple questions here. The first one, can we talk a little bit about standard auto policies in force. And I guess the question is, it continues to decline here. What can you do to kind of recharge that? Are you being maybe a little too conservative with respect to your pricing? I actually did see State Farm, I thought did file some rate decreases in several states recently.

Thomas J. Wilson

Brian, first quarter, are you an Allstate customer, maybe I general, if we get them one at a time. And that's the way we have been working it which is as George talked about, a good comprehensive all-in program. We believe in that our pricing strategy is the right long-term one, and we don't want to have big shocks up or down for customers. With that said, if we think we need to have a big shock up we in fact do that.

We also do file for rate decreases when we believe that it will give us a net present value positive. So I don't really have much -- we'd like it, would George like it to be growing faster? Yes. But when we set off this year, we said the most important thing is to make our combined ratio targets. And if we have to give up some growth to do that in 2008, that's okay, this is a long-term game we're here to win.

Brian Meredith
UBS

Are there any individual stakes that are problematic there with respect to TIF?

Thomas J. Wilson

Individual states that we are, that are.

Brian Meredith
UBS

And maybe there are states like California or something that something has been happening?

Thomas J. Wilson

I would say no place is problematic as it relates to spread, so this is not a free fall. If you look at where we are in terms of -- I would say if you said what states -- we're doing well in New Jersey, we're doing well in Georgia, Pennsylvania, Ohio we're kind of hanging in there in California and New York. We're not doing as well as we would like in places like Texas or Florida. Illinois is a kind of a rough market for us right now.

But those come and go. I mean, six months from now the list will be totally different because we have local teams who have their own strategies to how to win and compete in those markets. George and his team work aggressively in each of those places so that they all start to have success, but they don't all fire on the same cylinders all at the same time. Any other comments, George?

George E. Ruebenson

Yeah, there is no state that we're specifically worried about where we're losing share if that's what the question was, I'm sorry, the last few words dropped out. I didn't hear it but I don't know what State Farm is going to do. I do know that in the second quarter they took 12 increases and four decreases. So, they still seem to be worried about their margins.

The rest of our competitors have higher combined ratios than we are, so we're assuming they are going to have to continue to react the way they did in the second quarter. I would rather that we are growing; obviously, our agency force would rather that we are growing, but the economy is working against us. But we're not going to cut rates to chase growth. State Farm and Progressive tried that last year, it didn't work, and again, we don't think that price is the only thing that consumers are interested in.

Brian Meredith
UBS

Great. And then, second question on a different topic on life insurance, just quickly, Tom. The strategy had been for a while to increase return on equity in that business and I know you're taking capital out, expenses, etcetera, I guess the question now is, what is the return on equity in that business now going forward?

And would Allstate be better off being called a distributor of life insurance products rather than a manufacturer of those products, given your other businesses appear to have a much better return on equity?

Thomas J. Wilson

I would say we like to fit. We think we can reinvent retirement for consumers. We think there is a great opportunity to do that and capture not just distribution profits but underwriting profits, and putting our capital to work. We said we need to improve the return in that business, the big driver of improving that return has been fixed annuities, we need to do that.

When you look at the end of June, I think the return on equity is about 10%. So, it's above our cost of capital, not where we would like it to be. But it's also just because you have a hiccup in a market which is in this kind of market doesn't mean you abandon your strategy either.

Brian Meredith
UBS

Thanks.

Operator

Our next question is from Gary Ransom of Fox-Pitt Kelton. Your question, please.

Gary Ransom
Fox-Pitt Kelton

Yes, I had questions on the investments, as well. One is just the thought process and I wonder, you did some things in the second quarter. I wondered if you can layout the things that you were attempting to do last year in the first quarter and in the second quarter just to understand the evolution of what you were attempting to do?

And then secondly, I think you have said that munis are one of the more attractive investments right now in terms of after tax yield. Do you expect, is that still true today? Are you expecting to put more money with the thought being we'll still see a greater mix of munis in the future?

Thomas J. Wilson

Gary, Ric can answer the part two, but I'm not sure I got part one. Although we are referring to --

Gary Ransom
Fox-Pitt Kelton

I guess you have this big write-up here in the second quarter which outlines a bunch of things you did. And, but it wasn't like you were doing nothing in the first quarter. You were also taking a look and analyzing your mortgage exposures at that point in time. And I'm just trying to distinguish whether there was any kind of a quantum leap in thought process that we are doing something very differently now than we were in the first quarter or last year?

Thomas J. Wilson

I got it Gary. No, I would say we are not doing a whole lot different. In the first quarter, we did put a macro-hedge on you remember. But that's fall, sorry. Last fall we put a macro-hedge on for interest rates. We extended and expanded that and in fact we're in the middle of extending and expanding that now because we continue to think there is risk of interest rates going up.

We had a little bit of some hedges on in the equity portfolio. But again we just expanded those and stretched them out and layered them out. So the portfolio review is what we always do. We just went at it with, actually we put some extra resources on it. We have some people who are really good at looking at this from the outside who will work with us.

We had them look at it, these are our own people. So it's really more of the same. I think the increased disclosure is just our effort to continue to give transparency to you and our shareholders around investments because that is a topic which is very timely these days. Ric, do you want to talk about 33rd munis?

Eric A. Simonson

I'll just elaborate quickly on your last question, or on your answer. Gary, we did more than just trim the CMBS. We have been trimming financials for about 12 months. We filled the $0.5 billion of below investment grade exposure very early in 2008. And we actually sold some outside commercial mortgage whole loan office exposure where we had some outside deals and we got extremely good prices for them. So, this risk mitigation concept has been alive for some time.

On munis, yes, we view -- as long as the United States government and the states are offering the sort of tax arbitrage, if you will, associated with munis, those continue to work for us when we think about how we allocate assets to the businesses and capitalize on the low correlations between and among our businesses. Munis continues to look attractive to us relative to taxable fixed income. That said, if we are in early mid days of an economic contraction.

That's not a declaration of a forecast, but if we are, munis will lag in the accrual of challenges relative to the public corporate bond markets. And so states and municipalities are going to start feeling pressure from reduced tax base and the like. So all of that said, yes, we are targeting a higher exposure, not hugely higher, but higher, noticeably higher in munis. Remember that in munis we also run, in addition to kind of AAA/AA book, we run a non-rated book.

So, think that equivalent to below investment grade. It is relatively small, but it is very attractively juicy over a full cycle, and we'll continue to look and expect to find more opportunities. Remember this risk picture is not going to last forever. We're going to come out strong on the other side and one of the way we're going to make money is by returning to risk markets. And that aspect of the muni market, we are one of the most important players and it is one of our competitive strengths.

Gary Ransom
Fox-Pitt Kelton

Okay. Thank you very much.

Operator

Our next question is from Jay Cohen of Merrill Lynch. Your question, please.

Jay Cohen
Merrill Lynch

Good morning. Couple of questions. First is, I was kind of looking at the average price that you bought back stock in the quarter and looking at the stock price over the quarter and I was just wondering was there any point where you were out of the market for one reason or another?

Thomas J. Wilson

Jay, we have a policy of staying in the market as long as we can legally. So when we get around earnings or something like that, we have blackout periods where we have set programs which kind of work on auto pilot. But, in general, we try not to time the market.

What we do is look at the execution and so we look at the price at which we buy that stock back on a daily basis relative to the high/low weighted average and bunch of statistics to make sure we are executing well. But we try not to set a strategy, let's go out and buy another 100,000 shares today because we think the price is right. It's a long-term program and we think that's the right way to do it.

Jay Cohen
Merrill Lynch

Got it. And then the second question, you may have talked about this and I may have missed it, but you said you increased the liquidity of the holding company. I don't know if there are any issues behind that, why that was?

Thomas J. Wilson

We have always been -- if you look at our policy over the last decade, it has been to move money out of Allstate Insurance Company, up to the Allstate Corporation when we can and when we have the -- can do it under the regulatory scheme. So, we can't say we're doing any money up. So, there is really no change in that strategy. We just have to do with the pattern of available dividends under the statutory rules.

Jay Cohen
Merrill Lynch

Got it. Thanks a lot.

Operator

Our next question is from Paul Newsome of Sandler O'Neill's. Your question, please.

Paul Newsome
Sandler O'Neill's

Good morning, and thanks for the call. A quick question, do you have any thoughts on the change -- potential change in the regulatory environment for the indexed product and what impact that may have on your life insurance business?

George E. Ruebenson

I think what you are referring to is the registration aspect.

Paul Newsome
Sandler O'Neill's

Yes.

George E. Ruebenson

Is that correct?

Paul Newsome
Sandler O'Neill's

Yes.

George E. Ruebenson

At this particular time, that's still something that is in process and it is something that industry groups are on top of it and are working towards. But as far as our particular products are concerned, ours are probably more down the middle of the fairway than most.

We actually would feel fairly comfortable under any regulatory regime with respect to the products we offer. So, while it is an early issue for the industry and early item of discussion for the industry, it's not one that we have a particularly strong position about one way or the other.

Paul Newsome
Sandler O'Neill's

And on a separate, just to beat the investment dead horse just one more time. A couple of your peers -- smaller peers actually anticipate that they may end up with some more impairment given the current market environments. But you have done an awful lot of changes here.

Does that -- are you also in a position where you thinking that next quarter we should be thinking about at least some impairments or has what you've done this quarter really reduced that risk?

Thomas J. Wilson

Paul, this is Tom Wilson. The markets change every day. So we feel very confident about our valuations at the end of June. The processes that Sam and Ric and others have in place are in my belief the least state-of-the-art. We crawled all over this and we started that well over a year ago, really enhancing because we started to see more volatility. What happens in the future is anybody's guess.

Paul Newsome
Sandler O'Neill's

Great. Thank you. Appreciate the call.

Operator

Our next question is from Vinay Misquith of Credit Suisse. Your question, please.

Vinay Misquith
Credit Suisse

Hi. Good morning. On the risk mitigation efforts, could you expand on whether this is a new program or whether this is just an expansion of an old program?

Thomas J. Wilson

Vinay, it is what we do. It is what we do as well. There are some things that we have expanded. As we have mentioned the size and the duration of the -- I should say the breadth and the duration of the interest rate hedge, the same thing with the equity hedges. The ongoing portfolio activity is what we always do. We put a little more macro view on it. Ric said look, even if the assets themselves underlying the investments are great.

You have these rolling supply demand imbalances as people have trouble and so that impacts valuations. Maybe short-term, maybe longer term and so he said in those areas that are more subject to that kind of volatility, he wanted the ability to be able to sell those securities and so we said we might not hold those and we take opportunities. So, it is really extension of what we have been doing.

Vinay Misquith
Credit Suisse

Sure. Do you know when you plan to sell the $3.3 billion worth of fixed income securities?

Thomas J. Wilson

We may or may not sell those securities. It depends on what kind of price we get.

Vinay Misquith
Credit Suisse

Sure. Are you hedging the risk associated with your sub-prime and all-day securities right now?

Thomas J. Wilson

No. We did put some credit spread hedges in, but those are modest in size and scope because we think the CDS market is volatile and you have seen other financial services companies, actually, I think they reduce risk, there was increased risk and we are cognizant of not only leveraging our own capabilities but learning from other people's both successes and mistakes.

Vinay Misquith
Credit Suisse

Fair enough. One last question, on the auto side, I saw the average premium per policy for personal auto decline slightly this quarter versus last quarter. Year-over-year impact was up 1.4%, but it was down quarter-over-quarter. So, I just want to get a sense because I understand that pricing is up.

Thomas J. Wilson

It could be state mix. It could be timing. I wouldn't -- the general trend is up.

George E. Ruebenson

Yes, is up.

Vinay Misquith
Credit Suisse

Okay. Thank you.

Thomas J. Wilson

The problem is you get down to -- as I said to somebody yesterday, the price increase we're talking about is, about the price of a gallon of gas for six months on your auto insurance. I wouldn't over science it in terms of $0.50 a share or something like that.

Vinay Misquith
Credit Suisse

Sure. Thank you.

Operator

Our next question is from William Wilt of Morgan Stanley. Your question, please.

William Wilt
Morgan Stanley

Hi, good morning. Just a few quick clarifications for me, given the time. The discussion on Allstate Financial very helpful, I thought in the prepared remarks I heard reference to reduction or I guess operating income being 65% to 70% of an earlier level. Did I hear that right? And if so, would you just go over those one more time?

Samuel H. Pilch

Yes, this is Sam. It was 65% to 75% of recent history reported results for operating income.

William Wilt
Morgan Stanley

And that was your expectation going forward or the expectation for '08? How to frame that?

Samuel H. Pilch

Well, why we offer that insight was that we thought you would have challenge reviewing our results because of all the things going on whenever you have so many items going through, principally investment income, and then the reductions related to the risk mitigation. So, we thought that it would be beneficial to you to have that range of outlook.

William Wilt
Morgan Stanley

It absolutely is and thank you for that. Auto physical damage, loss cost trends, Same as, is that synonymous with what you disclose as property damage trends or are they broadly similar?

George E. Ruebenson

Yes this is George, are you talking about the 2.6%, is it indicative of what we have also seen in collision and comprehensive, is that what the question is?

William Wilt
Morgan Stanley

That's the question, yes. Thanks.

George E. Ruebenson

It is within that range. Yes, it is very moderate.

William Wilt
Morgan Stanley

Perfect. Thanks for that. And then the third quick clarification, sorry if I am off base, for George, California, good discussion of the rate changes and disputes there. Your Choice Auto in California, did I hear that for October?

George E. Ruebenson

Yes. It is a little bit different than in some of the other states. There is a couple of the discounts that we had to modify based on the regulation but fundamentally it is the same product.

William Wilt
Morgan Stanley

Perfect. And does the recent decision in the decrease in rates, I guess, how does that influence your view on the rollout or the aggressiveness of which you will rollout Your Choice Auto?

George E. Ruebenson

It is our intent to roll it out. It is our intent -- we are actually showing an increase in production in California right now. What we are seeing in the average premium is not a decrease of 16% because that's just the base rate decrease. We are selling at higher limits, higher values.

We are seeing some improvement in the average premium. As I said earlier we have already gone back and filed another auto rate increase. I do not know what the department ruling will be on that. But we do think that with some modifications the auto market in California is still pretty good.

William Wilt
Morgan Stanley

Perfect. Thanks very much.

Thomas J. Wilson

Okay. We will take three more questions and then we will let you be on your way.

Operator

Our next question is from Joshua Shanker of Citigroup, your question, please.

Joshua Shanker
Citigroup

Yes, good morning everybody. My first question regards your reinsurance program. Back when you put the major piece of the program price you had $875 million of savings from the prior year, if I'm not mistaken. When do we see that come through the P&L, is that over the next four quarters in even increments?

Thomas J. Wilson

The new program will start to come through the P&L in the third quarter but it doesn't all -- with the new numbers it doesn't all go through the bottom line, just to be clear about that. A big portion of the reduction is Florida because we have less risk in Florida.

And then you have some benefits in terms of reductions in the southeast contracts and a little bit of a reduction in the California contracts as well. But that number should start to go through you will see it more directly in premiums Josh, than you will in the P&L, right, because it doesn't all flow through the bottom line.

Joshua Shanker
Citigroup

But you will see premium, ostensibly, premium written and premium earned even if it doesn't fall to the bottom line should be up over the next 12 months by about $800 million or $900 million?

Thomas J. Wilson

No, that's too big of a number. The difference in the program is only a couple hundred million dollars.

Robert L. Block

We are still spending on a run rate $660 million.

Thomas J. Wilson

It's, what is it -- it goes from $920 million to $660 million. And so, you will start to see it but remember some of that is also Florida. We are down 100,000 policies in Florida over the last year or so. So, while the reinsurance cost goes away so does the gross premium we have got at the same time. So, I don't think you should expect to see it be one-for-one in either of the lines and whatever it is in the top line it will be less in the bottom line.

Joshua Shanker
Citigroup

Okay. Appreciate it. Second question do you have any comments on ad spend costs in a recession?

Thomas J. Wilson

Other than we always like them to be lower?

Joshua Shanker
Citigroup

Are you seeing your ad spend, your time per 30 seconds of advertising is that coming down in price at all, do you have any thoughts on that?

Thomas J. Wilson

I'm constantly amazed at the media market that they can always keep price increases even when the number of people watching the stuff goes down. So, I wish I could predict that it would come down. I can tell you that the industry ad spend was up of course, again last year. We are kind of flat this year. So I don't know what other people will do and there's a huge lag in that one. It takes like six months or something, George, you can give those numbers.

George E. Ruebenson

Yes, but we are continuing to spend a fair amount of money on advertising because obviously, we are still interested in growing.

Joshua Shanker
Citigroup

Thank you. And finally, is the whole of your investment portfolio protected from interest rate moves with this new hedging program or is it just certain securities that are protected?

Thomas J. Wilson

The interest rate hedge is a portfolio hedge but it is on $21.5 billion --

Eric A. Simonson

Of the Property and Casualty.

Thomas J. Wilson

Of the Property-Casualty because in the Allstate Financial remember you are matched off with liabilities.

Joshua Shanker
Citigroup

Okay and that actually answers the question perfectly.

Thomas J. Wilson

That was Sam's point earlier when he was talking about, you know, we mark the assets to market but we don't mark the liabilities to market in our industry.

Joshua Shanker
Citigroup

I appreciate your candor. Thank you.

Operator

Our next question is from Meyer Shields of Stifel Nicolaus, your question, please.

Meyer Shields
Stifel Nicolaus

Thanks. Good morning, everyone. I think in maybe George's prepared remarks you talked about a lost account in Encompass. I was hoping you could elaborate both on what you meant and what you are expecting to do with Encompass for the next 12 to 18 months?

George E. Ruebenson

Okay. The account we referenced was Hagerty, it is a classic car account. So because of that the premium was down a little bit. As far as what we expect from Encompass, we are trying to make sure we have the same discipline in Encompass as we do in the Allstate brand. So, we are pricing to a fair return.

We are keeping more disciplined than some of the other competitors in the IA market. That being said, we introduced a product called Edge last year and we are getting a pretty good boost out of that. So, Encompass is making reasonable returns, it is not growing as fast as we want, just like the Allstate brand is not, but the new products seem to be getting traction in the marketplace.

Meyer Shields
Stifel Nicolaus

Okay, that's helpful. If we could touch just a little bit on non-standard, I know you have been talking about Allstate Blue for about a year, maybe a little longer and we haven't seen much change in the year-over-year growth rates?

George E. Ruebenson

The reason for that is, is that we are still losing a lot of the old non-standard book and the size of that overshadows the growth that we are getting from Allstate Blue. In the Blue states we are getting an increase of well over 20% on a year-to-year basis, but that is all new business. And it does take a while as you know for the new business to cover the decline in the renewal book. We believe probably towards the end of this year beginning of next year the overall book will start to stabilize.

Meyer Shields
Stifel Nicolaus

Okay. Thanks so much.

Thomas J. Wilson

Okay, last question, I think.

Operator

Our final question is from David Small of JPMorgan. Your question.

David Small
JPMorgan

Yes, good morning. Just a quick one on reinsurance, given that there is a lot of capacity for reinsurance right now; would you consider buying more coverage to protect you against the, kind of, frequency events that we saw this quarter?

Samuel H. Pilch

Hi, this is Sam again. We have placed our program for 2008 and 2009 and it is still in excess -- it protects us -- first off it allows us to continue to offer property insurance throughout the nation and even some of the hot zones where we have higher exposure to catastrophes. It is intentionally designed to cap out our exposures across the nation with the aggregate, but also locally with the various components. So we're not looking at placing anything additional, especially at a lower working level.

David Small
JPMorgan

Okay. Thanks.

Thomas J. Wilson

Okay. Thank you all for participating. Thanks for the questions and the dialogue. Let me leave you a couple points; one, our insurance operations continued to be managed aggressively in what's a tough environment but we are successfully achieving our profit targets and we expect to continue to do that which is why we have improved our outlook.

Our strategy to reinvent protection retirement for the consumer, we have great people, great capabilities and great capital position and we are making progress on this front and we have lots of opportunity in front of us. And lastly, we take decisive action to react to the external environment to both protect and increase shareholders' capital. So, thank you all for participating and we will talk to you next quarter.

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