The Allstate Corporation NYSE:ALL

FQ2 2011 Earnings Call Transcripts

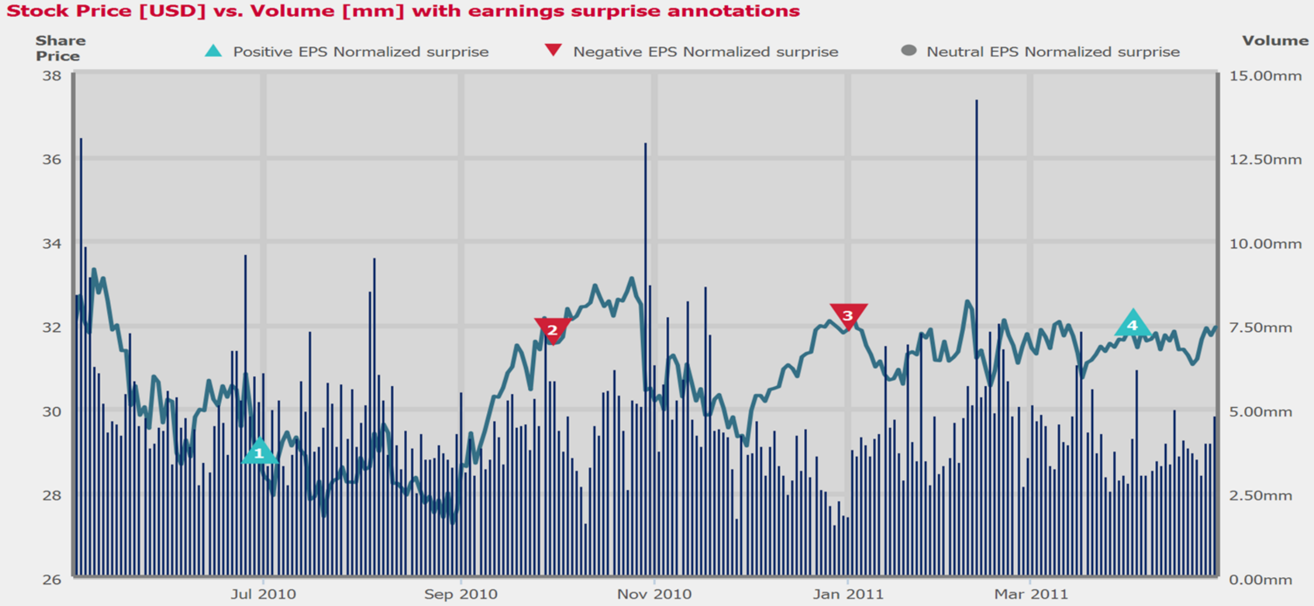
Monday, August 01, 2011 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2011-			-FQ3 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(1.55)	(1.23)	NM	0.87	1.32	3.83
Revenue (mm)	6473.14	6457.00	(0.25 %)	6560.50	26026.17	26367.04

Currency: USD
Consensus as of Aug-01-2011 1:31 PM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2010	0.72	0.81	12.50 %
FQ3 2010	0.96	0.83	(13.54 %)
FQ4 2010	0.88	0.50	(43.18 %)
FQ1 2011	0.68	0.93	36.76 %

Call Participants

EXECUTIVES

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

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

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Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Allstate Corporation Second Quarter 2011 Earnings Conference Call [Operator Instructions] As a reminder, this conference call is being recorded. I would now like to turn the conference over to your host, Mr. Robert Block, Vice President, Investor Relations. Sir, you may begin.

Robert Block

Thanks, Matt. Good morning, everyone. Thanks for joining us for Allstate's Second Quarter 2011 Earnings Conference Call.

Following our prepared remarks, we will hold a Q&A session, and we ask that you limit yourself to one question and one follow-up, so that we can get to as many of you as time permits. Joining Tom Wilson, Don Civgin and me for the Q&A session will be Judy Greffin, our Chief Investment Officer; Sam Pilch, our Controller; and Matt Winter, President and CEO of Allstate Financial.

Earlier this morning, we issued our press release and investor supplement, as well as filed our 10-Q for the second quarter. We also posted a slide presentation, which will be used in conjunction with our prepared remarks. All these materials are available on our website.

As noted on the first slide, this discussion may contain forward-looking statements regarding Allstate's operations, and actual results may differ materially. Please refer to our Form 10-K for 2010, our 10-Q for the second quarter and our press release for information on potential risks.

This discussion may also contain some non-GAAP measures for which there are reconciliations in our press release and on our website. Following the completion of this call, Christine Ieuter, and I will be available to answer any follow-up questions you may have. Now let's begin with Tom Wilson. Tom?

Thomas J. Wilson
Chairman & CEO

Good morning. We appreciate your continuing interest in Allstate. And following my remarks, Bob will cover the business unit result, then Don will go through our investment performance and then the financial position beyond the second quarter.

Before I begin a discussion on the results for the quarter, I want to comment on last month's management change at Allstate Protection. A decision was made and we've moved on. We have a strong management team in place. A blend of talented individuals, on both inside and outside the company. I am confident that everyone on the senior team understands what's expected of them. We are all driving toward the same goals off the same plan, a plan to grow our businesses profitably.

Now to the second quarter, we advanced our strategy of broadening our profitable protection relationships with consumers by utilizing both sophisticated risk tools, and then offering differentiated products tailored to specific customer segment, we will create significant shareholder value. Now while the weather hurt our overall financial results for the quarter, it had a much more significant impact on our customers' lives. This is why we're in business. I want to thank our claim employees and agencies for their dedication to our customers in these difficult times. This is when the value of having protection from Allstate really becomes evident.

Coming into 2011, we have 3 priorities: improve our operating results; grow our businesses profitably; and differentiate Allstate from the competition by focusing on unique customer segment. In the second quarter, our underlying businesses all showed continued progress towards the accomplishment of those priorities.

If you go to Slide 2, we improved our operating results throughout the company. In Property-Liability, the underlying combined ratio which, of course, excludes catastrophe losses in prior year reserve -- reestimate was a very solid 87.5, an improvement of 0.6 points relative to the second quarter of last year. Allstate brands standard auto combined ratio was 98.2 in the quarter, an increase of 3.7 points from last year. This increase was entirely driven by a significant increase in catastrophe losses.

Our underlying margins at Allstate auto improved relative to last year's second quarter, as loss trends moderated and efforts to improve results in Florida and New York take hold.

Homeowner margins excluding catastrophes held firm as we continue to drive towards acceptable levels of profitability. Operating income from Allstate Financial increased 12.8% versus last year, as improvements in the benefit and investment spreads, as well as lower operating expenses all contributed to improved results.

Investments increased portfolio yields through proactive risk mitigation and return optimization. We had realized capital gains in the quarter and unrealized gains increased by $900 million versus the previous quarter.

We obviously continue to proactively manage our portfolio. We did make several moves over the last couple of months, given the uncertainty surrounding the U.S. debt ceiling. Our assumptions are that any dislocation will be temporary and that the commercial banking system will continue to function, given the highly liquid nature of our portfolio and the long duration of our liability, this then obviously only has a limited impact on us. Nevertheless, we did a number of things. We sold treasuries, we put on some additional -- we sold our long treasuries. We put some additional hedges in place. We shifted the focus of our short-term portfolio. We underweighted equity and we continued our shift into corporate credit. We also increased liquidity by building up operating cash. And 2 weeks ago, we issued $400 million in commercial paper, and placed the proceeds in compensating balances to ensure we have cash to take advantage of any short-term investment opportunities.

As a result of all of our efforts in the second quarter, book value per share increased 8.2% from the second quarter of last year. It did decline slightly from the first quarter of this year, as improvements in our portfolio valuation did not offset the overall net loss.

In terms of growing the business. In Property-Liability, we're still declining in written premium and units in Standard Auto, primarily due to profit improvement actions in Florida and New York, which more than offset growth in the balance of the country. If you look versus last year, quarter-to-quarter, there are 27 states experiencing positive growth in Standard Auto policies in force.

Homeowner's written premium increased 2.6% driven by rate increases taken to improve profitability. Overall units went down slightly, as we downsized that business because of the cat loss exposure.

Canada and our specialty lines are showing strong premium in unit growth. Allstate Financial’s growth in underwritten products continued in the quarter, with half of the increase coming from Allstate Benefits.

Actions designed to reinvent protection retirement for the consumer continued to take shape. We continue to test our Claim Satisfaction Guarantee, which is now live in 4 states. We continued our rollout of Good Hands Roadside and Drive Wise. We've introduced new products at Allstate Financial, and then we announced a new alliance with Aetna and Allstate Benefits. And of course, while not all these initiatives will be successful, they're indicative of our strategy and approach to the market.

Going forward, we will continue to focus our efforts on achieving our long-term goals of improving returns and growing our businesses profitably.

Now let me turn back to Bob to cover our business trends.

Robert Block

Thanks, Tom. On a consolidated basis, we generated 5.6% increase from the second quarter 2010 in total revenue to $8.1 billion. The increase was due to $57 million of realized capital gains this quarter versus $451 million of realized capital losses in last year's second quarter.

Turning to the bottom line in the second quarter, we initiated a new disclosure policy around our catastrophe loss experience, where we provide our best estimate of catastrophe losses that is expected to exceed $150 million in the calendar month. Well, we picked a good quarter to start the process.

As we've already disclosed, catastrophe losses for the quarter exceeded $2.3 billion, and overshadowed many favorable underlying trends in our businesses. As a result, we posted a net loss of $620 million in the second quarter of 2011 versus a net income of $145 million in last year's quarter.

On an operating income basis, the loss in the quarter was $642 million, a swing of almost $1.1 billion from the second quarter of 2010, all of which was attributable to the difference in catastrophe losses between the 2 periods.

The Property-Liability on Slide 3. Net written premium of $6.6 billion was a slight decline of 0.4% compared to our experience in the first quarter -- comparable to our experience in the first quarter. We continue to balance our efforts to grow with our desire to maintain overall margins. Allstate brands Standard Auto net written premium decreased 0.9% quarter-over-quarter, driven by the combination of slight decreases in both units and average premium. Policies in force fell by 0.6% from June 2011 to June 2010. New business applications declined 5.2% in the quarter, while retention improved 0.2 of a point to 89.2%.

Actions to improve profitability in New York and Florida negatively impacted our growth in the quarter. Excluding these states, new business applications increased 2.4%, and Policies-in-Force grew by 0.2%. We continue to focus on profitable growth as it's critical to accomplishing our long-term growth and return goals.

Homeowners net written premium of $1.6 billion in the second quarter increased 2.6%, as we continue to gain approval for rate increases. For the quarter, the decline in units was more than offset with an increase in average premium. Importantly, retention held firm at 88.4%, up 0.1 from the second quarter 2010. In the quarter, we received approval for rate increases, averaging 6% in 18 states. Our long-term growth goal, which we provided at Investor Day in June, is to generate an acceptable return over time in this line of insurance.

Shifting to the bottom line. We recorded a combined ratio of 123.3 for the quarter, an increase of 26.5 points from last year's second quarter. Virtually all of this increase is accounted for by increased catastrophe losses. Catastrophes accounted for 36.2 points in the current quarter's results, an increase of 26.4 points in a combined ratio from second quarter 2010.

The underlying combined ratio, which excludes catastrophe losses and prior year reserve reestimate was 87.5, a 0.6 point improvement from the prior year quarter as loss cost moderated. We remain well within our outlook range of 88 to 91 for the year.

On the next slide, we show the loss components for Standard Auto. Frequency for both bodily injury and property damage improved relative to 2010 levels in the second quarter, with bodily injury frequency declining 2.3%, and property damage frequency falling 3.9%. Paid severity for both coverages shown on the upper right-hand corner of the chart increased minimally in the quarter, with BI up 0.4% and property damage up 1.1%. The combined ratio for the quarter was 98.2%, an increase of 3.7 points from the second quarter of 2010. The deterioration in the margin resulted from an extraordinary level of auto catastrophe losses in the quarter. 6.7 points of earned premium compared to only 2 points in the second quarter of 2010. The underlying combined ratio improved in the quarter and remains at solid levels of profitability. Florida and New York continue to have run rate combined ratios higher than the country-wide average, though the recorded results for these states have improved for 3 straight quarters, reducing the pressure on countrywide results. We continue to pursue profit improvement actions in these states, including rate increases.

On the next slide, we provide loss cost trends for homeowners. Excluding catastrophe losses, overall frequency was slightly better than the prior year by about 0.8% and paid severity increased 3.4% in the quarter. The underlying combined ratio improved slightly to 69.5 in the quarter. Our goal is to get the combined ratio excluding catastrophes in the low 60s by 2013, so more to be done here.

Turning to Allstate Financial, it continues to successfully execute its strategic plan designed to shift the emphasis from spread-based to mortality morbidity-based products, while increasing earnings in return. Our recent actions at Allstate Financial have stabilized the business and positioned it for continued strong consistent earnings.

Total premiums in contract charges in the quarter are comparable to prior year. Premiums and contract charges from underwritten products grew by $20 million or 4% due primarily to the growth at Allstate Benefits. Premium and contract charges from spread-based products declined by $18 million, including $16 million related to structured settlement annuities, which fluctuate with the changes in our pricing competitiveness in the market.

Net income for Allstate Financial was $166 million in the quarter compared to a loss of $107 million in the second quarter 2010. Operating income reached $141 million in the quarter, an increase of $16 million over the second quarter of 2010, as contributions came from improvements in benefits and investment spread, as well as lower operating costs and expenses. Actions to improve investment portfolio yields and reduce crediting rates on annuities, as well as higher profitability and growth in Allstate Benefits business led to the solid results this quarter.

Now I'll turn it over to Don.

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Thanks, Bob. We continued our practice of proactively managing our investment portfolio and it paid off again in the second quarter. On Slide 7, you can see that while the overall size of the investment portfolio stayed right around $100 billion, the composition changed slightly with the continued shift out of municipal bonds and government securities and into corporate securities. Also during the quarter, we executed on our previously communicated strategy of moving away from the short and long ends of the yield curve towards the intermediate portion of the curve. These actions, as well as realized capital gains and an improvement in our unrealized position are reflected in the strong total return for the quarter.

The next slide highlights portfolio income and yield trends through the second quarter. Overall, net investment income of just over $1 billion declined by 2.8% from the second quarter of last year, but was up from the first quarter of this year by $38 million. Within the Property-Liability portfolio, net investment income was comparable to prior year, as yield increases offset the slight decline in average assets.

At Allstate Financial, net investment income of $694 million dropped 4% from the second quarter of 2010 but was also up from the first quarter of this year. The change was due to an expected decline in average assets being partially offset with an increase in portfolio yields. Our success in improving investment income on a volume-adjusted basis was due to our actions to reduce lower-yielding assets, focused reinvestment in the 5- to 7-year part of the curve and increased investment grade in high-yield exposure, as well as strong limited partnership income during the quarter.

Slide 9 shows our realized and unrealized capital gains and losses over the last 6 quarters. In the second quarter, we generated $57 million in realized capital gains versus $451 million in realized capital losses in the second quarter of last year. Impairment write-downs of $70 million in Q2 were the lowest since the third quarter of 2007 and at roughly 1/3 of last year's levels. Realized capital losses on derivatives of $53 million were significantly improved as well. On the bottom of the slide, you can see that our unrealized capital gain position improved to $2.5 billion as well, favorably impacting our total returns for the quarter.

Moving to our capital position on Slide 10. We remain strongly capitalized after the extraordinary catastrophe losses we experienced in the second quarter. Shareholders' equity of $18.8 billion declined by $500 million from last quarter, but remained $800 million above year-ago levels. With the increases in the portfolio valuation substantially offsetting the net loss for the quarter, book value per share finished at $35.95, an 8.2% increase from the second quarter of 2010 and 1.8% above year end 2010.

Statutory surplus levels remained strong at an estimated $15 billion for Allstate Insurance company and $3.5 billion for Allstate Life Insurance Company. We paid a $238 million dividend from AIC to the holding company during the second quarter, bringing holding company invested assets to $3.5 billion. This is down a little from March levels due to our quarterly dividend payment and the repurchase of $232 million of stock. We still have $308 million remaining under our stock repurchase authorization and expect to complete the program by March 2012.

On the transaction front, we're proceeding with the dissolution of the Allstate Bank. Our deal with Discover was terminated due to approvals not being received by the date set, but we still have high confidence in completing the wind down of the Allstate Bank. With regard to our pending acquisition of Esurance and Answer Financial, we're working with regulators to obtain their approval and already have received federal antitrust approval. We expect to complete this transaction later this year.

In closing, despite the record catastrophe losses during the quarter, Allstate remains in strong financial shape.
Now we'll open it up to your questions.

Question and Answer

Operator

[Operator Instructions] Our first question is from Jay Gelb of Barclays.

Jay H. Gelb
Barclays PLC, Research Division

Tom, my first question is, can you give us your thoughts going forward on the leadership within the P&C business, how you plan to structure that?

Thomas J. Wilson
Chairman & CEO

In the interim period, people are reporting either directly to me or to other members of our 16-person senior leadership team.

Jay H. Gelb
Barclays PLC, Research Division

Okay. And then separately on capital management, the pace of the buyback looks like it's on track to finish well before early 2012. Just wanted to get your thoughts on that, whether Allstate might be buying back stock into hurricane season. And then how should we think about Allstate's level of excess capital taking into account the $3.5 billion of liquidity at the holding company?

Thomas J. Wilson
Chairman & CEO

Jay, we buy back stock as we think it's appropriate in markets we have extra cash flow. Given the loss this quarter, we started slowing down a little. We still expect to finish the program on time with where we said it would be, which is first quarter of next year. As it relates to overall capital management, we obviously have a long track record of returning capital to shareholders, if we don't have a use for it. The $3.5 billion at the parent company level, some of that is necessary to make sure we have some cushion for dividend, debt repayments and interest payments. We don't have any debt repayments coming due anytime soon, so it's mostly for the first and the latter. And that tends to be somewhere in the $700 million to $1 billion range. The rating agencies prefer to be around $1 billion. The other amounts we use as appropriate. So about $1 billion of that will be used to purchase Esurance. And then we look at the share repurchases, every time we finish a program, we look at what we want to do going forward. That tends to be based on our outlook for profits and what we think the underlying trends are in the business, as well as keeping some extra cushion for the volatility, which comes from catastrophes.

Operator

The next question is from Bob Glasspiegel from Langen McAlenney.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Tom, just reading the financial press. There's been a flurry of articles suggesting that morale is not good with agents, employees and shareholders, and your recent decision to make the management change was not well-received by Wall Street analysts with 3 downgrades. I recognize Wall Street analysts are probably a distant fourth to the other 3 constituents. But where is the company with respect to morale and does that get in the way of executing your plan?

Thomas J. Wilson
Chairman & CEO

Bob, we wouldn't hold you in that category. Let me maybe deal with it in pieces. As it relates to the agency owners. The headline there would be, look, we're successful in moving through the change necessary to execute our strategy. I'll give you a little historical background. I've personally known and worked directly with the agency owners for over 13 years. Last week, I was with 15 of our senior vice presidents, who run the field force and about 1,000 of our top performers for 3 days. And I also created and work closely with the National Advisory Board, which is a group that actually represents the 11,000 agencies we have. They are highly supportive of our strategy, which is to make sure their businesses are focused on personal-touch loyalist segment by offering a broad set of differentiated products. Now to do that well, we have to do a couple of things. We're going to have to increase the average size of our agencies and we're working to align our compensation system with individual performance. So these are hard things to do, particularly when you're fixing the homeowners business, where you're getting smaller and raising prices in that segment. But we've successfully come through changes in the past. We're well on our way to doing this together. Last week, for example, on compensation, we talked about how we incorporated their feedback and we were given an ovation by the agency owners. I'm not -- we get to where we are together. We get from where we need to go together. So these are people who are passionate about helping people, running strong local businesses. And together, we'll start to grow that business. So we're completely aligned and putting more resources behind their growth and helping them achieve their objectives. So I think we're fine there. It's always -- if morale is always a little better when you're growing and everything's good, but we're also aligned and are locked arm-in-arm to go forward here. As it relates to the employees, we're in fine shape as it relates to the employees. As it relates to shareholders, I think we would all, as a shareholder and Chairman of the Board, we'd all like to see the stock price higher, which is just -- we'll keep working on doing what we do best, which is run the business, make money and get it to where we're going.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Okay. Switching gears, how excited should we be by the favorable frequency trends in auto in the quarter in New York, Florida? Are the problems put behind us or is victory within sight for the overall results to show favorable frequency trends? Or was that just a nuance to how the weather flowed this quarter?

Thomas J. Wilson
Chairman & CEO

Bob, I would say you should feel comfortable that we know how to run that auto business and make money in it. We've done it for a decade. The frequency specifically in the quarter was down really across all coverages. PIP was down in Florida, so we're feeling good about our actions there. But if you looked at it in total, I would say it's in the range of normal fluctuations. The second quarter of last year was actually a little bit higher than is traditionally the case in the second quarter. So you get quarter-to-quarter comparisons skewed a little bit. Underlying theme as I like to think about it, look, we know how to run that business, we know how to make money in it.

Operator

Our next question is from Mike Nannizzi of Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Just on the New York, Florida item. In 2010, you'd shown, I think, x Florida and California, just trying to get an idea of PIF trends outside of New York and Florida over the past year. Can you comment on that? And also outside New York and Florida, can you comment on the trend in combined ratio over the past few quarters? And just one follow-up.

Thomas J. Wilson
Chairman & CEO

Mike, a couple of things. As I mentioned in the comments about, in 27 states quarter-to-quarter, we're up in items in force. If you just look this year, that number is 30. So the number is moving in the right direction. That range of up is from a low 1% to some are up 4% to 5%, we have a couple up at 8%. So the business is growing outside those areas. That said, we get paid to grow the business in total, so we have to fix Florida and New York. Those businesses are still shrinking in size, and we're on the way to having those fixed. But there's a whole bunch of things still going on there. There's a new chiropractic schedule in New York, so there's -- we're not out of the woods on New York and Florida yet, but we're well on our way to having it fixed. So I feel good about the underlying business model we have. And saying that, that works. We got to make it work in all states, so we grow the overall business.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And just so -- just because, so in outside of New York and Florida, you're seeing PIF growth, but can you talk about if you're seeing PIF growth and what's happening on the combined ratio side?

Thomas J. Wilson
Chairman & CEO

Yes, I'm sorry, the combined ratio in those states is better than the average you see for the whole country because New York and Florida are above that level. You did see -- you didn't ask this, but you did see a small drop in average premium this quarter, which is in part due to some great investments we made to drive growth in those other states and that's working and those combined ratios are still highly attractive.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay. So you're seeing growth and the combined ratio is tracking. Are you seeing -- I'm just trying to understand combined ratio trend, PIF trend, if there's any way to kind of show what those are, talk about what those are outside of California and Florida -- New York and Florida, I should say.

Thomas J. Wilson
Chairman & CEO

Let me leave it with this, we're feeling pretty good about where we are in the rest of the country. We feel our business model hunch [ph]. It's not an easy market with the amount of advertising going on these days, but we like what we see. The biggest driver for us will be to continue to push retention up, which means not only doing a better job for our customers and everybody else but also selling them more products, and we had a really great quarter on selling Allstate Financial products. We've launched new products there. So we're liking the multi-line aspect of that, which we do as well.

Operator

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

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

If I could just maybe follow up on the past couple of questions. For the New York and Florida, to the extent you can, can you give us any sense of timing of when that might work itself out, quarters, years what we're looking at there? And then on the issue of the morale and the agents, now that everyone's had a little bit more time to think about Esurance, has there been any specific feedback or vibe on that, and maybe if you can update on that?

Thomas J. Wilson
Chairman & CEO

As it relates to New York and Florida, there's not a whole lot more to say. I mean, we're making progress there. We don't have a specific date at which we'll think it's completely done. I will tell you that we are starting to focus more on how do we grow in those markets, now that we've made some pretty good progress on getting the underwriting stuff done. So what we need to do is not only improve profitability there, but grow those markets, so that we can grow the overall piece. As it relates to Esurance and the agency owners, they're fine. Actually, many of them are quite excited about it because what we've done is said we're going to focus their efforts on personal-touch loyalists. The Esurance will be focused on self-directed customers, who want a branded experience. They understand the difference. They got it. The additional work we're doing to improve the customer value proposition with them, they're very excited about. And we've also, we loaned money to agency owners at quite -- at attractive return for them and us to help them merge agencies. We are increasing the size of that new mass business and so we're feeling good. Everybody is, I think, aligned around doing it. So we don't -- there's not a -- sometime you’ll see reports that people think it's going to be like channel conflict. This is about doing what the customer wants. Everybody gets it. Everybody knows if we do what the customer wants, we'll all win and that's what we're focused on.

Operator

Our next question is from Vinay Misquith of Evercore Partners.

Vinay Misquith
Credit Suisse

Two questions. First was on the underlying profitability of homeowners. So it's good to see that there's a 30-basis point improvement year-over-year on the accident year combined x cats. Just wondering, just a little surprised because earned premiums were up 6.6%, and the frequency and severity up maybe, flat to up 3%. So what's happening here? Why aren't we seeing a faster improvement in the underlying profitability?

Thomas J. Wilson
Chairman & CEO

First, a couple of things. Overall, we need to deliver a combined ratio for homeowners insurance that includes everything, not just cats. You do have to be a little careful at looking at combined ratio x cats because it's not the same measurement on the revenue side as it is on the cost side. Let me give you an example. So if we decide, we are taking hail deductibles up because we think that's the right thing to do for our customers and it's economic for us, that actually would increase your non-cat combined ratio because you would be giving up premium but you would also be giving up losses but those losses are not included there. So I want to just caution you a little bit about getting too focused on that specific one down to 0.1 of a point. It obviously needs to come down in total because we need to be collecting more money for catastrophes. But I don't want to -- every 0.2 or 0.3 of a point may or may not be indicative of what's going on in the trends of the business. So we feel good about where that business is going and how we're driving it. What was the second part of your question?

Vinay Misquith
Credit Suisse

What rate increases -- I hear that you're taking rates up around 6%. So...

Thomas J. Wilson
Chairman & CEO

Wait, wait, sorry. Yes, I get it. The overall -- we like the overall trends in the business. There's obviously -- you get a lot of quarter-to-quarter fluctuations, particularly if you look at like fire coverages. Fire amounts to less than 10% a year units, but a good 40% or so of your losses. So to the extent you get any kind of swing there, it bounces around the frequency and severity a lot, so you really do have to look at paid pure premium. If you're up 6 in average earned premium and you're up only 3 in your paid pure premium, which is the combination of both frequency and severity, that obviously means your margin is going to get better. We've been pushing through large rate increases in the homeowners business since the beginning of 2009. It takes a while for those to get through the business, but we feel good about where that trend is.

Vinay Misquith
Credit Suisse

Fair enough. And just as a follow-up to that, some competitors are taking rates up maybe around 8% to 9%. Where do you think you need to take rates up near term to get to your targeted profitability?

Thomas J. Wilson
Chairman & CEO

Well, I -- the question obviously is asked in total as opposed to by state. Some states this year even, we filed for numbers with 2s on them. There are some states, where we're filing single-digit increases. So it's, of course, varies wildly by state and with inside of state. But if you were to use the total combined ratio, we have non-cat today, let's call it 69. We'd like to be in the low 60s to handle normal cat. That means you need 10 points or so of price on top of that, which looks like what we've been doing over the last, like, 18 months. Obviously, some things change when you do that. People change deductibles and that kind of stuff. So it moves around a little bit. You might not get all that through the written premium. But we are well on our way but we're not there yet. And so, you should expect to see us continue to file increases in homeowner rates at least probably the next year to 18 months.

Operator

Our next question is from Matthew Heimermann of JPMorgan.

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

I guess question on net investment income and specifically, I guess, this is related to some of the change in derivative and portfolio hedging. And I guess on Page 32 to 34 of the Q, it shows a pretty big reduction, if I'm reading this right, in terms of the net investment income of headwind from interest rate contracts, especially. And so one, I guess, am I reading that right in terms of kind of thinking about that as the impact of that being helpful to investment income? And 2, was curious if you could give us a sense of how that breaks down between P&C and Life?

Thomas J. Wilson
Chairman & CEO

Matt, let me maybe break it into 2 pieces and ask Judy to do it. First, we have the investment income but then the derivatives, as stuff goes through the capital gains loss line. So I'm not -- I'm a little -- I want to make sure I get your question right. So Judy can talk about what we're doing on investment yields perhaps, and then we can talk about derivatives, what we've changed there. Is that...

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

Well, if I could just clarify. I guess, that had historically kind of been my presumption, but as I was reading the Q this morning, it just struck me that the presentation presents it as a reduction to net investment income and then a reduction to realized capital gains, and then there's a reduction to policyholder crediting or benefits. And then other expenses. So that's why I'm re-asking the question and if that's still wrong, then that's fine.

Thomas J. Wilson
Chairman & CEO

Why don’t we do this -- why don't we -- if we put -- why don't we answer, what are we doing with investment yield. That will give you the investment income piece. Then, why don't we talk about what happened economically in the derivatives space this quarter versus where we were last year at this quarter. And then we can figure out how to reconcile that with what's on the page, this stuff in the Q with your asset [indiscernible]. Will that get you where you’re going?

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

Yes, that's perfect. And I guess, with kind of the goal of putting in perspective the pretty big sequential leap and that investment income this quarter.

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

Okay. So I think I can address the derivatives question when I talk about yield as well. So if you think about it in 2 buckets, the first is the core portfolio, which is predominantly fixed income. Quarter-over-quarter, stabilize the yield, stabilize the income, actually the yield improved, but if you look at the income, it's largely stabilized. The benefit that we saw quarter-over-quarter largely came from the equity side of the equation. First, foreign dividends, which if you look back at Q2 2010, you would have seen the same pattern, did quite well during the quarter, and that's largely seasonal. LPs we've had about 3 solid quarters of LP results, and LP showed up during the quarter as well both in income, as well as in realized cat gain loss, the EMA LP show up in realized cat gain loss. And then the hedge component that you may be referencing also benefited us in the quarter. During the first quarter, we unwound some hedges in Allstate Financial, paid fixed hedges about $1.3 billion and that showed up as a net investment income improvement to the quarter of about $16 million. So that's how we got to the $38 million improvement in income quarter-over-quarter. So maybe that addresses your derivative question.

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

That's helpful, I might follow up with an additional clarifier, but that is helpful overall. And then I guess just in terms of the life insurance side, the crediting rate dropped pretty precipitously in 1Q. It's kind of holding steady here. So when we think about the interest rate spread from here given what you're saying about your yield on the portfolio, that's probably a -- that relationship is probably pretty fair. Is that a fair assumption?

Matthew E. Winter
President and President of Allstate Insurance Company

Yes, Matt. This is Matt Winter. Yes, I think that's a pretty fair assumption. We have been fairly aggressive in crediting rate actions. You see it somewhat in contract holder withdrawals. We pierced the bailout in some of our products. I think we're at a fairly stabilized level right now and so I think that the ratios you see should continue. There’ll be some natural volatility there as contracts come in and out of withdrawal periods. But generally, it's a fair assumption.

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

Okay. And if we saw 6 months from now 10-year rates, 50, 60 basis points higher. How much -- how quickly should we expect that crediting rate to change?

Matthew E. Winter
President and President of Allstate Insurance Company

That is such a complex question. That depends upon how fast it goes up. That depends upon where contracts are in bailout periods and withdrawal periods. I really can't answer that without misrepresenting it.

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

Can I try a different way then? How in basis points, whether it's 50, 100, 150, how significant a move in the 10-year would we need to see before you'd expect the crediting rate to start to change materially?

Matthew E. Winter
President and President of Allstate Insurance Company

I'm still not sure I can answer that and give you an accurate reflection.

Thomas J. Wilson
Chairman & CEO

Matt, if you look at our overall portfolio. Matt's kept it short. We have a negative duration, so if you're after what happens if interest rates go up, we think we are positioned to do well if rates go up. Obviously, as rates go up, it has a negative impact on the value of that which we own.

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

I got that, Tom. I was just more specifically asking about the crediting rate on Allstate Financial. But appreciate it.

Operator

Our next question is from Josh Shanker of Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I don't want to make the call all about New York and Florida, but I just was curious if we could parse the complications in premiums and whatnot between objective goals in lowering homeowners and the loss of auto policies associated with that and rate changes because you just don't like the margins for the auto business in those 2 states. Is there a way of, like, sort of, understanding how those 2 components are moving in there?

Thomas J. Wilson
Chairman & CEO

I'm not sure I’m with you, Josh, on the relationship. I can tell you what we're doing in those 2 states on both lines and then maybe that will...

Joshua David Shanker
Deutsche Bank AG, Research Division

Maybe a little bit, but if we're losing premium, how much of the premium you're losing is intentional because you're losing it in terms of a bundle that you're losing, and how much are you losing because, look, we didn't like the policy, we're changing the rate?

Thomas J. Wilson
Chairman & CEO

Well, there are 2 different stories here. In Florida, we're down to about a 3% share of the homeowners business and into the low teens on auto. We made that change over the last 5 years or so. And we managed our way through that by -- and we actually grew our auto share when we did that. So we feel good about the work we did. Now we do broker a lot of business through our agencies, to other people, so that our customers still have bundled coverage, but we manage our way through that. In New York, it's more regional than the whole state, which you have in Florida. So if you get east of Sunrise Highway up on Long Island, it's a different story than if you're in the boroughs or in upstate obviously. So those 2 things are moving along apace. We don't have as fast a pace on improving the catastrophe exposure position in New York because it's much lower probability. So you do these things according to when you think you can, when you have to. And so we're pushing ahead on that one. We've lost less auto customers in New York than we thought we would lose given the work we were doing at homeowners. So we feel good about the way we're managing the business. It doesn't mean that if we offer somebody coverage with another company and not us, that they don't get mad and take their auto policy and go someplace else. But by and large, we have a good set of relationships, definitely manage our way through it. In terms of the auto rates, that tends to be, again, more segmented by type of customer. And so bundled customers tend to be getting less of an increase than non-bundled customers, who tend to be the people who drive more of the PIP losses. So we feel good about being able to do both things. What we do need to do in the auto business is fix the profitability in both places and then to come up with a plan to grow. Because if you're not growing in those 2 states, it's pretty hard to grow in total.

Joshua David Shanker
Deutsche Bank AG, Research Division

And that's a multi-quarter situation?

Thomas J. Wilson

Chairman & CEO

Yes.

Joshua David Shanker
Deutsche Bank AG, Research Division

And the other question I had, unrelated. I want to know if I can think about consolidated ad spend for Esurance and Allstate over time. Would the 2 combined companies be spending less on ads than the 2 separate companies? Or how should we think about that?

Thomas J. Wilson
Chairman & CEO

Well, first, you would always expect us to do what's economic. So it isn't just sort of who's got more money to throw out in the marketplace, so we always look to see what's economic. It's our belief that what we're spending at the Allstate agencies is economic today, and we'll continue to spend at that level to the extent introducing new products, more bundling helps us, we'll spend more money there. Esurance, we know through our research that we can increase the ad spend and improve the economics through its affiliation with the Allstate brand. So if we say, Esurance and Allstate company, we know that improves close rates and consideration levels, both of which give us the ability to spend more money on advertising, both of which should enable us to continue to grow that business pretty aggressively.

Operator

Our next question is from Dan Johnson from Citadel.

Dan Johnson
Citadel Investment Group

I actually wanted to circle back on a numbers question I think was asked but I wasn't sure if it got answered. I think we’ve talked about California and New York or growth outside of those 2 geographies. In prior quarters, we've talked about instead the impact of New York and Florida. Can we retouch on those? And just let me know if you're still giving out those numbers on sort of the x California and Florida new app trends and then I've got a follow-up.

Thomas J. Wilson
Chairman & CEO

Dan, I’m a little confused. I think most of it, we've been talking about New York and Florida. California doesn't -- I don't think it's been in people’s questions. California is a state where we need to grow. You’ll remember in 2008, we took a $250 million rate decrease on Standard Auto in California. As a result of that, we slowed down growth there and there's some new laws came in place, so we had to redo our rating plan. And that was just approved and we've been in the market 3 or 4 months at this point. We feel good about the results we have. We do need to start growing California. We have seen a pretty -- a nice uptick in retention in California in the last quarter.

Dan Johnson
Citadel Investment Group

Maybe I should have been a little more concise in the saying, if we want to look outside of New York and Florida, can you give us a sense as to what sort of sequential changes over the last couple of quarters we've been seeing on the production front?

Thomas J. Wilson
Chairman & CEO

In total? It's about -- okay, Bob can give you some breakout by stuff. But I would say, in total, it's -- you're getting it low-single digit growth outside of New York and Florida.

Dan Johnson

Citadel Investment Group

Yes. And how -- okay, that's perfect. Then how would that have compared to maybe the last couple of quarters?

Thomas J. Wilson
Chairman & CEO

It's not accelerating the way I'd like to see it.

Dan Johnson
Citadel Investment Group

Okay, great. That's question one. And question 2, I don't know where I saw this, but there's -- maybe it was a Bloomberg story on agent and unionization and it seemed like a bit of a one-sided story, so maybe you could tell me a little bit more about what's going on, whether or not the agents are going to vote to join the AFL-CIO. And if that's the case, I was going to say, how to -- a better way to put it, does it have any impact? Does it matter?

Thomas J. Wilson
Chairman & CEO

Well, first, as I mentioned earlier, we're successfully moving through the change with, in conjunction, in tandem with our agency owners. We have 2 groups, the National Advisory Board, which I established in 2002, I think, or 2003. We also have the Agency Executive Council, which is a group. Those 2 groups we work actively with to shape everything from how should we get agencies bigger, to what should we do on compensation, to how should we help you grow in your local market. So there's a lot of work we do in conjunction with our agency owners every day. I mean, obviously, they own businesses that are worth billions of dollars, when you add it all up. They're important to our customers and so they're important to the overall equation we have. The group you're talking about is a small group. We think it's a small group. It's not officially any group that anybody really interacts with the company on. They've been -- they've appealed to be a guild, which is somehow affiliated with the AFL-CIO to -- but a guild doesn't mean anything, if you want to form a union, you actually have to be recognized by the National Labor Relations Board. A similar effort was done in 2002, and they were not approved as a group because they are independent contractors. They are still independent contractors. The important point is after 2002, we started working very hard to, and the reason we formed those 2 groups was let's get a line and do this together. And so, we've been in a good place. This group is led by somebody was hasn't been with the company for over a decade. So we don't spend much time with them.

Operator

Our next question is from Cliff Gallant of KBW.

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

We're seeing a lot more commercials from Progressive about the rollout of its Snapshot product and I was curious, what your thoughts were on that as a competitive threat.

Thomas J. Wilson
Chairman & CEO

Well, you are seeing, they are putting a big push on that. It's a new way of pricing, which is in part related to a new customer value proposition but it's a relatively narrow one. We have something called Drive Wise. We're in a number of states with it. It's all device driven. It has a fair amount of appeal to certain segments of the population. It's not at all appealing to other segments of the population. So we think that the connection between cars and the telecommunications connections between cars, getting your car to serve as a cell phone on wheels, lots of things will happen that we can develop broad customer value propositions around. We have a number of efforts, we call them the connected car effort, which is there's very -- there's many pieces of that. One of which is our Drive Wise program, which we're continuing to roll out and test to make sure it works with people. But there are other parts to that value proposition as well. So I think, if I lend a little more macro flip, it's a little bit like we talked about in June which is, the competition in this industry 10 years ago was really based on getting more sophisticated in price. About 5 years ago, it became who had to throw weight in the marketplace on advertising. And now it's shifting to -- those 2 are still in place, so they never go away. It's now shifting to who can really do the right job for customers and our strategy is unique customer offering for people who want to buy bundled products. So selling more Allstate Financial products, selling more specialty lines. We're up, we had decent growth in Allstate specialty lines, which is boats and renters and that kind of stuff so, motorcycle insurance. So you'll see more of the competition shift to things like that, which will be either unique ways in interacting with customers or different value propositions, which is probably why...

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

Is there a potential for something like that to be sent to policyholders of different companies? For example, I know with Snapshot, they only do it with their own customers. But is -- as a branding or marketing tool, was there anything that would prevent Progressive from sending the snapshot to your policyholders?

Thomas J. Wilson
Chairman & CEO

What do you mean, if they wanted to do a direct mailing of the device to our customers?

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

Right, right.

Thomas J. Wilson
Chairman & CEO

I mean, I suppose they could. The devices are a little expensive. So I don't know. I mean, important is, -- I mean, you can mail anything to our customers. They're all pretty American, so there's really -- would we want to mail their device to our customers? No, obviously not. So yes, they could mail the thing out. But it's -- I'm not sure it's a great economic deal for them because your breakage rate on direct mail’s pretty high, and sending out all these devices would be pretty expensive.

Operator

Your next question is from Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Two quick ones here. First, Matt, I think you kind of touched on this one a little bit with Mr. Heimermann's question. But just curious about the big increase we saw in surrender activity in the quarter, anything unusual there. Is that something we should expect going forward? And what impact may have that had on income in the quarter?

Matthew E. Winter
President and President of Allstate Insurance Company

Yes. Brian, it's Matt. So we did have an elevated level of contract fund withdrawals in the second quarter but it was not unexpected. So we had expectations based on historic sales levels. And during the first 6 months of 2011, we saw an increase compared to the same period, the first 6 months in 2010. And those variances were driven primarily by increases in surrenders and withdrawals on deferred annuities in the second quarter relative to the same period last year. So we had a higher number of contracts, which were the T-Link contracts and the ChoiceRate contracts that reached the 30- to 45-day window period, where there's no surrender charge. We also took some crediting rate actions on our equity indexed annuities, where we lowered those cap rates and pierced bailout rates. We did that knowing that we would have an increase in surrenders, as a result of that. We believe that in balance, it was the right thing to do economically for the company. We in all of this have to balance what's good for the policyholder, what's good for the company, what's good for our ability to continue to sell those products in the marketplace. So it's a kind of a careful balancing of all 3 interests, but we saw exactly what we expected, and we think we did the right thing for all 3 constituents.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then quickly for Tom, with respect to the initiatives that you currently have with the captive agency force and trying to get an average-sized agency a little bit larger, any change in the pace of how that's going to be implemented here going forward?

Thomas J. Wilson
Chairman & CEO

The pace begins with how do we do a good job for our customers. And so anytime you -- if an agency owner decides they don't want to grow the business and they'd rather merge it with somebody else, we'd like to make sure that we have all the processes in place so that the customers are taken care of. We've been working hard on those processes over the last year or so, and we're in position to do that well today. The pace really is driven though, Brian, more by what the agency owners want to do. We don't – as the lowest performing agency then we don't give you as many options. But the large portion of our agencies get to make their own choices when -- with the compensation programs we're putting in place, it should give them a good transition period and the choice to make a decision when it fits for them and their business needs. So we’re at about 11,000 agencies today. We don't have a goal as to what number do we went to get to by the end of the year. What we do know is we need to increase the average size of them, so as long as we're doing it in a way that makes sense for our customers, will make sense locally and fits with the business needs of the people who own those businesses, works okay with us. So I don't think you should expect to see a huge rush up or down, it just sort of -- it's what we always do. In every business you're doing this, you're always adapting to change, figuring out how you do a better job for your customers. And some people make the change and come with you and really benefit from it, other people decide they want to do something else. And that's fine, you just have to do it with respect and dignity over time.

Operator

And our final question today is from Keith Walsh from Citi.

Keith F. Walsh
Citigroup Inc, Research Division

Just one question around homeowners, if I think about the 6.5 million policy owners out there. How many of those have an auto policy in addition to homeowners and how many are a standalone homeowners customer?

Thomas J. Wilson
Chairman & CEO

Yes, I'm sorry, I'm looking at Bob, I mean should we...

Robert Block

[Indiscernible] home is probably in the 40s.

Thomas J. Wilson
Chairman & CEO

Yes, I know what the number is. I just want to make sure – I wasn’t sure whether you disclose it or not. It's about 40%. And we have -- that number has gone up pretty dramatically in an absolute number in the last year. We had a very targeted focus on going out to mono-line homeowners and saying, "Oh, by the way, your price is going up, but we have a bigger discount on auto. So if you'll roll your autos to us, you can probably, either -- you can certainly reduce and perhaps eliminate much of the increase by bundling with us." And that's been highly successful in terms of the increase and that's part of our strategy, which is we'd like -- we need to increase the number of products that people buy from us whether that's auto and home; auto and life; auto, home and life. What we do know is the broader our relationships are, the longer those customers stay, the better relationship they have with those local agencies. And those are the kind of people who want that local agency relationship and that's a specific unique customer segment. We're going to deliver everything we need to do for them. Separate segment would be what we do with the self-directed people and we're likely to offer bundled products there as well, it's just, we'll do it in a different way.

Keith F. Walsh
Citigroup Inc, Research Division

Okay. So is that 40% that are mono-line homeowners you said?

Thomas J. Wilson
Chairman & CEO

No, it would be 40% that are auto -- home and auto customers.

Keith F. Walsh
Citigroup Inc, Research Division

Okay. So I guess just with that other 60%, I mean, you guys were kind enough at the Investor Day to give us a little more disclosure about roughly 30%, I guess, of your equity tied up in the homeowners insurance business, which we all know has not made money in several years. Why wouldn't you just run that piece of the business down, where you have no implication on the rest of your book on your auto book?

Thomas J. Wilson
Chairman & CEO

Well, it's not as simple a question as that because not every one of those -- let's take a 60%. Not every one of those are not you earning a good return on. So many of those customers, you do earn a good return on despite because they're not in a cat zone or they haven't had those kind of losses. Secondly, we believe that the -- we can, it's a great opportunity for us to sell them auto insurance. I'm sort of a -- I don't want you to think about it as auto insurance-centric, right? Auto insurance is our biggest product but we really are customer-centric. We'd like to sell whatever our customers want to buy. So if they want to buy homeowners and a life policy from us, that's good. If they want to buy homeowners and a boat policy and a life policy, that’s good. So really think about it as how do we grab as many customers and sell as many things as we can to them. We want to make money on all those things. So it's not a good strategy to -- as you point out, to sell money to a customer, have them buy one thing from you and lose money on it. But that's rather than just jettisoning them, we think there's a great asset there that not only can we make money on what we do sell them, we believe we can sell them other things, we'll make money on too. So it's not as easy and fast as you might describe besides the fact of getting rid of -- if you were to try to jettison another 3 million or so homeowners, there’d be a little bit of -- you'd have some regulatory issues anyway. But that's not -- it's not -- our strategy is to make money on what we sell them, and sell them more.

Thank you all for participating today. Our goal is obviously to improve returns and then grow our businesses by having differentiated offerings for unique customer segments. We'll see 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.