S&P Global
Market Intelligence

The Allstate Corporation NYSE:ALL

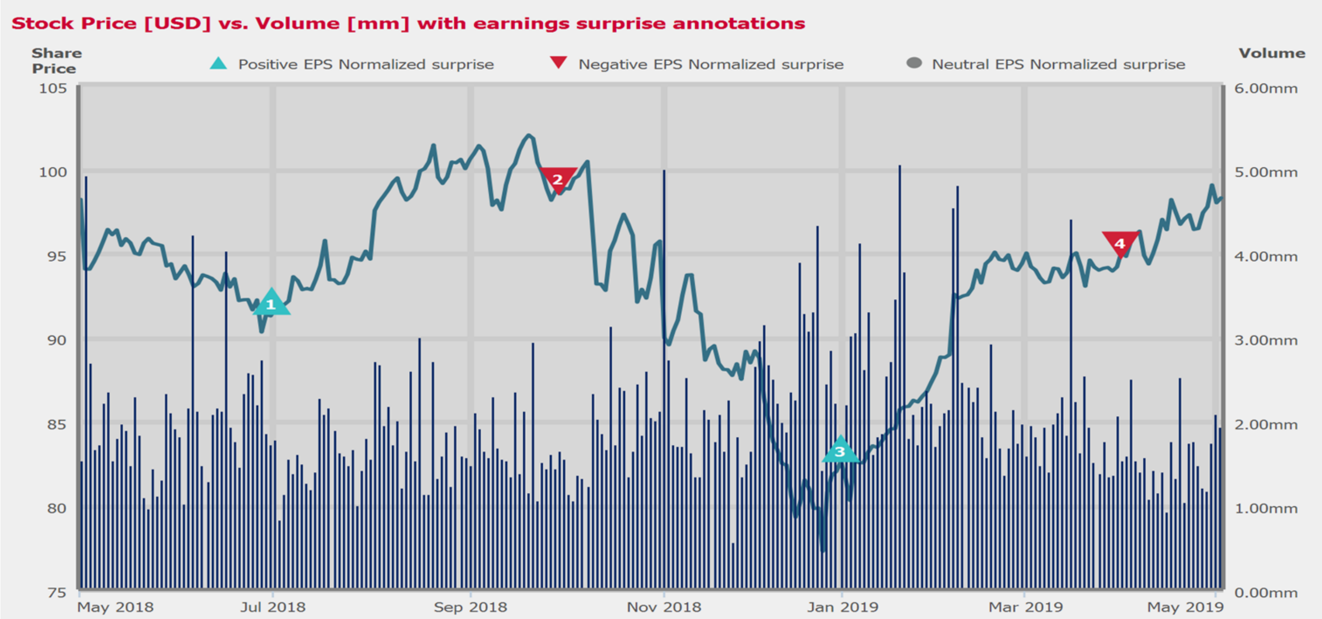
FQ1 2019 Earnings Call Transcripts

Thursday, May 02, 2019 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2019-			-FQ2 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	2.32	2.30	(0.86 %)	1.89	9.16	9.90
Revenue (mm)	8816.33	8802.00	(0.16 %)	8976.00	35644.00	36862.33

Currency: USD
Consensus as of May-02-2019 11:28 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2018	1.50	1.90	26.67 %
FQ3 2018	2.25	1.93	(14.22 %)
FQ4 2018	1.16	1.24	6.90 %
FQ1 2019	2.32	2.30	(0.86 %)

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Call Participants

EXECUTIVES

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President of Service Businesses - Allstate Insurance Company

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

Jesse Edward Merten
Treasurer

John Griek
Director

Mario Rizzo
Executive VP & CFO

Steven Emil Shebik
Vice Chairman

Thomas Joseph Wilson
Chairman, President & CEO

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The Buckingham Research Group Incorporated

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

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

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Presentation

Operator

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

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

John Griek
Director

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

Yesterday, following the close of the market, we issued our news release and investor supplement, filed our 10-Q and posted today's presentation, along with our reinsurance update, on our website at allstateinvestors.com. Our management team is here to provide perspective on these results. And Jess Merten, our Chief Risk Officer, has joined us today to discuss how we evaluate risks and return decisions and use economic capital to allocate resources and establish performance targets.

As noted on the first slide of this presentation, our discussion will contain non-GAAP measures for which there are reconciliations in the news release and investor supplement and forward-looking statements about Allstate's operations.

Allstate's results may differ materially from these statements, so please refer to our 10-K for 2018 and other public documents for information on potential risks.

Now I'll turn it over to Tom.

Thomas Joseph Wilson
Chairman, President & CEO

Well, good morning. Thank you for joining us, to stay current on Allstate. Let's begin on Slide 2 with Allstate's strategy to profitably grow market share and protection products, starting with the upper oval, the personal Property-Liability market that hits 4 consumer segments and provides protection by insuring automobiles, homes and other properties. We use 4 brands, differentiated products, sophisticated analytics, telematics and are building an Integrated Digital Enterprise to grow market share in this protection space. Our strategy also includes expanding by protecting people from a range of other uncertainties, such as shown in the bottom oval, by leveraging our brands, customer base, investment expertise, distribution, claims capability and capital. Collectively, these businesses on the bottom oval have tremendous value, which often gets overlooked by investors who focus only on the Property-Liability businesses or on earnings per share. Our strategy creates shareholder value through customer satisfaction, unit growth and attractive returns on capital. It also ensures we have sustainable profitability and a diversified business platform.

Moving to Slide 3. This strategy is driving growth and attractive returns. Policies in force increased for the Allstate and Esurance brands, Property-Liability businesses. SquareTrade hit outstanding growth. Total policies in force now exceed $123 million.

The Property-Liability underlying combined ratio was 84.2 in the first quarter. Total return on the investment portfolio was strong at 4.7% for the last 12 months, but reported income declined this quarter due to lower valuations and limited partnership portfolio. Net income was $1.26 billion, as you can see from the chart on the bottom, reflecting strong operating results and significant capital gains under the accounting policy where equity valuation there reflected in net income.

Adjusted net income was $776 million or $2.30 per diluted share in the first quarter. Adjusted net income return on equity was 13.5%, which is a broader measure of how we do from an overall return standpoint than just the underlying combined ratio.

Let's turn to Slide 4. We had a good start on 2019's operating priorities. The first 3 priorities: better serve customers; achieve target economic returns on capital; and grow the customer base are intertwined to ensure profitable long-term growth. Customers were better served as the enterprise Net Promoter Score improved, and customer retention increased across our 3 underwriting brands. Returns remained strong, both in total and for our individual businesses, as Jess will discuss.

The Allstate Esurance brands grew policies in force by 2.3% and 10.9%, respectively, which resulted in the Property-Liability policies increasing by 833,000 compared to the prior year quarter. When compared with a significant -- when you combine that then with a significant growth at SquareTrade, total policies in force now exceed $123 million.

The $84 billion investment portfolio total return was 4.7% for the last 12 months. Net investment income for the quarter was adversely affected by lower performance-based results reflecting lower private equity at the valuations. The performance-based portfolio did generate $57 million of capital gains this quarter.

We continue to make progress building long-term growth platforms, expanding our relationship with the transportation network to 15 states. We're growing telematics usage, and SquareTrade is adding capabilities and expanding markets while achieving its acquisition goals.

Mario will now go through the segment results in more detail.

Mario Rizzo
Executive VP & CFO

Thanks, Tom.

Moving to Slide 5. You can see that Property-Liability results remained strong. Net written premium increased 6.2% the first quarter due to policy growth in the Allstate and Esurance brands and higher average premium across 3 underwritten brands.

As you can see in the bottom left table, total policies in force increased to $33.4 million or 2.6%. The Property-Liability reported combined ratio of 91.8 was 4.3 points higher than the prior year quarter primarily due to higher catastrophe losses. The underlying combined ratio, which excludes catastrophes and prior year reserve reestimates, was 84.2 for the first quarter of 2019.

In the quarter, we changed to a fair-value-based accounting method for pension and other postretirement benefits. This change benefited the underlying combined ratio by approximately 0.2 points in the first quarter relative to the prior method.

Our full year outlook for the underlying combined ratio on 2019 was established at the beginning of the year at 86 to 88, but we do not adjust the range based on 1 quarter of results.

Moving to the right-hand table. Allstate brand auto and homeowners insurance network and premiums increased by 4.7% and 6.8%, respectively, due to policy growth and higher average premiums. Higher average premiums reflect rate changes of over 3.7% in homeowners and 1.4% in auto insurance over the last 12 months.

Esurance's auto insurance rate changes were 2.3% over the last 12 months, which, combined with policy growth, show total net written premium growth of 13.4%.

Encompass written premiums are essentially flat as higher rates were offset by lower policies in force.

On the bottom of the table, you can see the underlying combined ratios were all good in the quarter.

Moving to Slide 6. Our Service Businesses are growing rapidly and creating shareholder value. SquareTrade revenues increased 34% to $164 million in the first quarter of 2019 driven by significant growth in policies in force. Adjusted net income was $11 million, an increase

[Audio Gap]

from the prior year quarter due to $14 million of profits at SquareTrade, as you can see on the right.

Arity continues to invest in advancing our telematics platform at a small loss. Total mileage analyzed is now about 10 billion miles per month and 350 trips per second. Allstate Roadside Services revenue was $73 million for the quarter with an adjusted net loss of $6 million comparable to the prior year quarter. Allstate Dealer Services revenue was $107 million in the first quarter. Adjusted net income was $6 million, benefiting from improved loss experience.

InfoArmor, which was acquired in October 2018, had revenues of $24 million with over 1.2 million policies in force. The adjusted net loss of $1 million was due to costs associated with scaling its platform for growth and integration into Allstate. We also acquired iCracked in February, which will expand SquareTrade's protection offerings.

Turning to Slide 7, let's review Allstate Life, Benefits and Annuities. Allstate Life, shown on the left, generated adjusted net income of $73 million in the first quarter, up 2.8% from the prior year quarter as higher premiums and investment income more than offset increased contract benefits and expense. Allstate Benefits adjusted net income, shown in the middle chart, was $31 million in the first quarter. The $2 million increase from the prior year quarter was primarily driven by lower contract benefit. Allstate Annuities, on the right, had an adjusted net loss of $25 million in the quarter due to lower performance-based investment income. While the utilization of performance-based investments improves long-term economic returns, it increases income volatility for the Annuities segment.

Let's move to Slide 8 and discuss our investment results. We proactively manage the investment portfolio, considering relevant market conditions, the nature of our liabilities and corporate risk appetite. Our investment portfolio generated a strong 4.7% total return over the last 12 months, of which 3.3% was in the first quarter. The components of return are shown in the chart on the left. The blue bar represents net investment income, which is included in adjusted net income and varies between 80 and 110 basis points per quarter. Approximately 75% of this is from interest income on fixed income investments, which make up 69% of the portfolio.

The change in the value of the bond portfolio and equity investment obviously varies by quarter, which is why we discuss total return over a 12-month period. Valuation changes in the quarter benefited from the client and risk-free rates, tighter credit spreads and the strong rebound of public equity markets.

The chart on the right shows net investment income for the first quarter was $648 million, $138 million lower than the first quarter of 2018. Market-based investment income increased to $693 million from $652 million, reflecting a modest duration expansion for the Property-Liability fixed income portfolio, partially offset by a reduced allocation to high-yield bonds.

The performance-based portfolio generated investment income of $6 million in the first quarter lower than the prior year and recent trend, reflecting lower private equity asset valuation. The performance-based portfolio did generate $57 million of capital gains as the ownership structure of certain investments requires we report capital gains rather than investment income.

Slide 9 provides an overview of returns and capital. Our capital position remained strong, and we paid $158 million in common shareholder dividend in the first quarter of 2019.

As a reminder, the Board of Directors approved an 8.7% increase in the quarterly dividend per common share to $0.50, which was paid on April 1, and it's not included in the amount returned in the first quarter. Common shares are being purchased through a $1 billion accelerated share repurchase agreement, which began in December 2018 and will be completed this week. Upon completion of this agreement, we will have about $1.9 billion remaining in our $3 billion share repurchase authorization.

Total shares outstanding at the end of the first quarter were 6% below the prior year, so each shareholder owns 6% more of the company. We continue to generate attractive returns on capital with adjusted net income return on equity of 13.5% for the 12 months ended March 31, 2019.

And now Jess will provide an overview of how we economically evaluate risk and return.

Jesse Edward Merten
Treasurer

Thank you, Mario.

I'll start on Slide 10 to discuss how Allstate uses sophisticated analytics and economic evaluations to allocate capital and establish performance goals. Our approach to capital allocation can serve multiple perspectives while allowing us to focus on optimizing returns for the individual risk. This begins with establishing economic capital requirements for individual risks by product such as auto, home or life insurance, investment risks such as interest rates or equity valuation by business and for the entire corporation.

Capital requirements are based on cash flow projections and probabilistic models, especially for extreme events like catastrophes, and we incorporate expectations through regulators and rating agencies. This approach allows us to evaluate risk at a granular level to enable us to optimize economic results. Our diversified portfolio of businesses results in capital benefits that we're also incorporating into our strategic capital allocation process. We retain the benefit of risk covariance between market base and businesses at the corporate level so that each business earns an appropriate standalone return.

As a result of these processes, Allstate's capital position is strong and performance exceeds return threshold. About 3/4 of capital is utilized by the Property-Liability business. All major businesses earn returns above the cost of capital other than annuities.

We dynamically allocate capital based on risk and return characteristics to establish performance targets. I will discuss 2 examples, Esurance and homeowners insurance, to show the benefits of this approach. Let me walk through these points in more detail.

Slide 11 provides an overview of our process for determining economic capital. Economic capital is the amount of capital needed to accept risks given expected returns and the range of possible outcomes. This is determined using a sophisticated framework built on our experience and data related to individual risks.

In the middle of the slide, you can see we use a 4-step process to determine economic capital. Step 1 is to identify the unique risk and return attributes for different types of standalone risk. We start with hundreds of individual risks that are grouped into 35 standalone risk types. The examples include auto insurance underwriting risk or interest rate risk. So there, we determine required capital for each line of business by aligning asset and liability risks and estimating correlation between those.

For example, in establishing capital for auto insurance, accident frequency is uncorrelated with investment risk associated with reserves, so this reduces economic capital.

In step 3, we aggregate the risk by products in line with business that comprise each market-facing operation such as Allstate brand's personal line, Esurance or Allstate lines. The covariance between this type is retained by the market-facing business so required capital reflects an integrated risk profile.

The final step is to combine the risk groupings in step 3 to quantify the capital required for the entire corporation with a diversified portfolio risk. This 4-step process results in overall economic capital being less in each market-facing business as diversification between noncorrelated risk lowers Allstate's overall risk level. This covariance is retained by the corporation so that each business must earn an appropriate return for its risk profile.

In setting the consolidated capital target, we also consider regulatory and rating agency guidelines and overall financial flexibility.

Turning to Slide 12, required capital by line is shown on the upper left piechart. Approximately 1/3 of economic capital is used by auto insurance and about 40% is needed for homeowners insurance, which is heavily influenced by the catastrophe exposure. We use economic capital, industry performance into each content with that of performance part of our business. Actual results are then needed to evaluate performance from a growth and return perspective as shown on the upper right.

First, you can see all major market-facing businesses earned returns above our cost of capital on a standalone basis, except annuities. The highest return business is Allstate brand's auto insurance.

SquareTrade has higher returns in growth, but because of its relative size and modest risk profile, it generates less absolute income than Allstate businesses.

Moving to the bottom of the page. Esurance provides a good example of how we use this to evaluate performance in comparison to reported results. Esurance has a combined ratio of over 100, but it generates a return on capital above our target. As a result, we've invested aggressively in growth. On the lower left, you can see Esurance's combined ratio has been above 100. A large part of the combined ratio, however, is advertising, which is immediately expensed to generate all of these [interstate] agreements for years. When we acquired Esurance in 2011, we decided to invest aggressively in advertising, which has totaled about $1.3 billion and all has been spent immediately. This has worked because Esurance now has $2 billion premium which is more than twice its original size. To ensure this is economic, we established performance targets for each vintage year of business. The combined ratios start out high, as you can see on the lower right chart, to reflect both the new business count and the significant advertising cost. The combined ratio of each vintage year, however, then declined dramatically since there are no advertising expense and pricing changes were implemented. The combined ratio of below 100 did generate cash, which then combined with investment income resulted in returns being above our target through all vintage years.

Slide 13, which is homeowners insurance, is an example of how economic capital supports the process to establish performance goals within market-facing businesses. As we saw in the previous slides, over half of the required capital for homeowners is due to catastrophe exposure. We allocate this by state as shown on the upper left pie chart.

Texas, shown in blue, had significant storms such as hurricanes, hailstorms and tornadoes. So its homeowners business must generate return on the capital needed for these risks.

New York, shown in dark red, also had substantial risk -- potential risk from hurricane, while the probability of loss low in catastrophes is a concentration of high-value homes on Long Island and Allstate's significant market share results in a large asset amount of capital required to cover this risk. Notably, Florida, shown in orange on the lower right of this chart, is small in absolute dollars because of our extensive use of reinsurance and market share that is below 2%.

We use this analysis to establish combined ratio targets, which vary by state. And as you can see from the top right chart, targets differ between high-capital and lower-capital states. Our top 5 states utilize 45% of Allstate brand homeowners, insurance economic capital with the average combined ratio of a target of 83. This compares to the remaining 45 states which utilize 55% of economic capital at an average combined ratio target of 88. This approach ensures we achieve strong aggregate returns based on economic targets that reflect the underlying risk in these states.

We adjust these targets as the exposures change. And in total, this has declined over the last decade, which you see from the bottom left chart. In establishing targets, we also compare ourselves to competitors and want to have a competitive price and better performance. As shown on the chart on the bottom right, we have a better combined ratio than Progressive, Liberty Mutual and State Farm while being competitively priced for the value we deliver and earning attractive returns. These sophisticated capital allocation capabilities serve us well in delivering our strategy while generating attractive risk-adjusted returns on capital.
Now we'll open the line for your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Jay Gelb from Barclays.

Jay H. Gelb
Barclays Bank PLC, Research Division

On personal auto, in particular the Allstate brand, we're hearing a little bit more about increased competition on rates. I was wondering if you could touch base on that in terms of what you're seeing from a competitive standpoint and also how Allstate is adjusting that issue to.

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

Thank you. This is Glenn. Yes, we're seeing definite competition out there. If you look at the CPI a year ago, it was at 9%. Now it's in the 2s. That said, we like our competitive position. It's something we monitor in each state on an ongoing basis about how we're doing, both competitively and from a returns standpoint. Our new business is up. Our retention's up. And I think the most encouraging sign is that the system is healthy and that we get about 3,000 more people in that system selling our product than we did a year ago. And these agents are investing in hiring more salespeople, and they're smart small business owners and they only do that when they feel like they can compete. So it's a competitive market out there. I know you've heard that from others in the market, and you can see the rates that are getting filed, but we like our position and our ability to grow.

Jay H. Gelb
Barclays Bank PLC, Research Division

Appreciate that. And then within the Allstate brand, on the so-called commercial lines business, can you talk a little bit about exactly what that is and what's driving the fast growth?

Steven Emil Shebik
Vice Chairman

So Jay, this is Steve. So at commercial lines, we generally focus on smaller businesses. That's been our historic business for a long time. So a lot of our policyholders also own businesses. We're on a marketplace with -- in 10,000 communities in the United States which is most communities. So we have a presence, and we want to insure not only autos and homes, but other things in their lives, as Tom noted at the beginning, in terms of broadening our protection.

You remember back last March, so March of 2018, we signed an agreement with Uber to insure some of their states and some of their drivers. So we had 3 states originally. So when we added a fourth in June. And just March 1 this year, we added 11 more states. So the growth you've seen over the last 1.5 years or 1.25 years is really based on that Uber relationship.

Jay H. Gelb
Barclays Bank PLC, Research Division

I see. Can you characterize the -- or generally characterize the profitability of that line?

Steven Emil Shebik
Vice Chairman

If you look at our progress, we say it's early for us to really analyze how we're doing in that. We are recording at our priced loss ratios. We feel we're pretty good with those, but the history is not really there. More than half of the potential claims from the T&C is to be liability coverages, so there's a longer tail on those. And as you know, these business have not been in business for more than a handful of years of any size. And so as we see the market changing and those companies growing rapidly, you need to be careful and conservative in your reserving in pricing.

Thomas Joseph Wilson
Chairman, President & CEO

So Jay -- and then we price -- a little perspective -- so when we first set up the relationship with Uber, of course, they were doing a bunch of it themselves, so -- and they were using some other people. We had access to all that data.

One of the reasons we're of value to them as a partner is our claims capabilities. And so we can look in quite a fair amount of detail on how to handle those types of injury claims. And so we're confident that we're in a good place.

Operator

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

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

My first question, I guess I'm going to focus on your -- the last piece of your presentation around capital allocation. I was wondering if you could talk a little bit about the balance between maximizing ROEs and investing in the business. In your chart, specifically the one on the upper right-hand corner of Page 12, where you identify Arity, the annuities business and Roadside Services as running below your cost of capital hurdles. And I suppose this is in the context of the published reports of the possibility of the sale of your annuity business.

Thomas Joseph Wilson
Chairman, President & CEO

Okay, let me take it, and then Jess, if you want to jump in at -- on the annuity piece. So first, Greg, we invest -- we run the business for the long term. We try not to run it for quarterly earnings. So in 2011, in the bottom of the crisis for us, we were still investing heavily in advertising. So we always try to look long term at whatever we're investing in. It doesn't mean we keep throwing money after good money after bad. We do watch our expenses quite closely, but -- so we try to take a longer-term view of that. It also applies to annuities, and it applies to Arity.

Let me do Arity first and then annuities second. So Arity, while as -- one of the things Jess said is that, that's a stand-alone number. And so Arity -- but if you look at Arity in terms of the whole company, the amount of value it's creating for us in our insurance business is in terms of better pricing. It's a net win for us. So we evaluate them independently, but then we look collectively at how they work for the whole company.

The same thing is true with annuities. So annuities, we've talked about multiple times, right? Annuities are not a good business for us from a return standpoint on 2 basis: one is economically; and two is in the financial books. If you look at the economic piece of that, that's because these are long-dated liabilities. Long-dated liabilities like a pension fund should be mostly invested in equities, and the regulatory capital requirement for investing in equities is quite high. So you should be investing in equities, but when you put all that money in equity, the money doesn't bring your current return down. Even though on a long-term basis, it's absolutely the right thing to do. We chose to do that anyway, and what we do is we allocate a portion of that corporate covariance in our own money. We can still manage the overall corporate results, but we need to allocate a portion of that corporate covariance, which is obviously a capital reduction to that business.

Financially, it's also not a good return business for us, and that's because the way the reserving has been done and required for years has been when you set up the reserves initially, you don't change it. And there's a few odd changes to what you were. But generally, you don't change it. If -- when people live longer, because these are payout annuities, you don't change your reserves. And when interest rates go down, you don't change your reserves.

And so as a result of that, there is a liability that is bigger if you look at it from an economic standpoint. We factor that into Jess' numbers. Jess has it all factored into how we look at the company. It just doesn't show up on the financial book. So the risk of new accounting -- things coming out, which Eric talked about, both in the K and the Q, that will change that accounting. And what that changed accounting will do is basically take those losses that have been incurred economically in the past that we factored into our analysis into the balance sheet and will definitely be a material change to the balance sheet. So we're -- always still manage long term, think economically. Cash flow is what drives us, but we're cognizant of what's going on in the financial results and try to help you see when those numbers are at odds. Is that helpful?

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

Yes, it is. Just a point on -- and I have a second question, but a point on your annuity comment. The material charge or the material event as it relates to annuities, that's expected to happen in the fourth quarter 2020 or 2021?

Thomas Joseph Wilson
Chairman, President & CEO

The -- it's required to be adopted in 2021. But as like always the case in these things, you can choose to do what you want once you figure it out. But it's complicated.

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

Okay. My second question, switching gears to homeowners. The Allstate brand homeowners underlying combined ratio still feels like it's running a little bit higher or a little bit above target. And the Encompass homeowners underlying combined ratio is even higher than that. And I'm just curious about your perspective about the homeowners business. Do you feel like that's a market where there's more rate in the pipeline? Do you -- are you satisfied with the returns and the growth profile?

Thomas Joseph Wilson
Chairman, President & CEO

Let me start up top, and then Glenn and Steve might want to make some comments about Allstate brand and then Encompass. So first, we love the homeowners business. We get really good returns in it, and we help customers because it is something that -- with this level of catastrophe, it's really important for them today. And so when you look at the -- you're talking about the underlying combined ratio. I think 4 or 5 years ago, we started talking about it should be in low 60s. I think it's about 63 right now. That doesn't factor in the fact that the catastrophe losses have come down over that period of time as well. So we don't talk and we don't share our specific targets by line, by state, with people because it's just too complicated a conversation to have over time, but we feel really good about our overall returns in homeowners.

I do think that the Encompass returns are not as good as they need to be, and Steve will talk about what he's doing to do that. That said, we manage our business at a granular level. And -- if everybody doesn't get an A on every test, we don't, like, throw them out of class, right? So some states are good, and then we have to work to get them back. Some brands are not as good on something, we work to get them back and price them. Glenn can talk about what he's doing in profitability in the first -- in the Allstate brand because we're -- again, we don't sit still on it even though we have good returns. We have work to do. Steve can talk about Encompass.

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

All right. Yes. So I always -- first number I look at, just for context, I look at the recorded combined and then the underlying because if you really think about this business, we're accountable to manage the catastrophe risk, too. So over the long period of time, you really want to produce an underwriting profit. And the last 7 years, I think there's only been 1 quarter that we didn't produce an underwriting profit. So it's been a good stable business. So building on Tom's point, we like homeowner and we like the return we're getting overall with homeowner with 92 in the quarter.

But your question is right in that the underlying has ticked up over time, particularly if you look at the last 5 quarters or so. And last quarter, I said to you that we had, last year, a very wet year, a lot of noncat weather. So more rain and less hail was my line. I think I regret that line now. Actually a lot of hail in the first quarter.

And so you look at the weather patterns, and it is something we have to respond to. We did take a couple of points of rate in the first quarter. And the other thing I'd point you to is we do have inflationary factor built into home. So sometimes we only focus on filed rate, and if you look at the trailing 12 months, it's 3.2. But the average premium is up 4.5 because of the inflationary factor. So if you take 2 1 in the first quarter and about 3 points in the last 2 quarters and look at inflationary factors on there too, we are responding and reacting to sort of new weather patterns.

Steven Emil Shebik
Vice Chairman

So when you look at Encompass, Tom said -- did very well. We believe we need to take some actions in order to raise the returns and then lower the combined ratio we have in the business. We do have a little bit different footprint than what the Allstate brand has, a little bit more concentrated. Obviously, it's a much smaller book of business. There are areas where we appoint agents and there wasn't a lot of business. We don't have the same broad footprint that the Allstate brand has. So that leads them places where we have certain concentrations in areas that sometimes have significant catastrophe exposures and sometimes we have no exposure in areas. So California wildfires, we've had areas where we've had significant losses you may have seen a year before last and other areas where we had none. So the things we're working on to improve the business, there are a number of states we need to have significant rate increases. We're working hard to achieve those, to get those particular locations up to our cost of capital and above.

Secondly, we're looking at our footprint, trying to reduce that concentration. So in some areas, we are appointing agents away from the areas we are. Other, we're trying to constrain business to underwriting in areas wherein -- where we are too highly concentrated.

And lastly, we're working on our processes -- claims, pricing sophistication so we can create that closer and better for the risk that we have. So we hope that over time that we'll get a very similar result as Allstate brand has. That's our goal.

Operator

Our next question comes from the line of Elyse Greenspan from Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question, going back to the auto environment a little bit more. Your new business growth, which you did highlight in response to an earlier question, did slow year-over-year this quarter. I know it obviously is last quarter -- last year was a pretty good new business growth year for your auto book. Was that expected? Or are you seeing kind of any change out there as some other peers are also now taking less weight and also looking to grow?

Thomas Joseph Wilson
Chairman, President & CEO

Thanks, Elyse. Yes, there's no question that, as I mentioned before, that CPI is down. And for context, when you look at the CPI, about 2.4% in the first quarter, that's a trailing 12 months basically because it's the rate that as people open their bill that month, what kind of surprise are they getting. And obviously, this year at 2.4% increase on average versus a 9% the prior year does create less shoppers. That said, I think you've put it in your question well that this is an increase over what was a high base. We had a strong year last year and a strong first quarter last year on new business, and we're increasing over that. And that's sort of the health of the system overall.

Steven Emil Shebik
Vice Chairman

Elyse, I would -- and Glenn said this earlier -- also focused on retention. So our retention was up half a point. That's half a point of growth. And that's half a point of growth to all our new business [peril] associated with it. One of the things we obviously want to focus on and one of the reasons are -- one of our operating priorities is to better serve our customers. It's good for them and good for us.

So the other part is I think a lot of people focus on this. The percentage changes that are out there, that is important. The other part is what's your absolute price. So while some people have reduced their price recently, we still think we have a highly competitive price relative to them. So they're just coming down closer to where we are as opposed to taking us out of market.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. That's helpful. And then my second question on -- you guys filed -- provided your updated on catastrophe reinsurance program last night as well. It seems like your nationwide cover, you have the tower goes a little bit higher compared to where it was last year, greater cap on usage in the program. And it seems like your costs only modestly went up. I wasn't sure if you could just talk to us a little bit about placing the cover and what you saw in terms of the market and the price there.

And then as you think of placing in the Florida portion of your coverage, is there anything that would indicate that maybe what you're seeing in the pricing there would be different than when you place the nationwide cover?

Mario Rizzo
Executive VP & CFO

This is Mario. I'll answer your question on reinsurance. So I'll take you back to what Jess talked about in the presentation around how we think about risk, return and capital because reinsurance is one of the ways that we kind of optimize the risk and return profile of our homeowners business, and we use reinsurance extensively. And we posted the details around our national excess of loss cap program yesterday. And we did increase the top of our tower a bit. So we bought coverage up to $4.86 billion after a $500 million retention on a per event cover.

In addition to that, we repeated in the cash rebond market what we started last year, which was placed a cap on it that provides both excess of loss cover as well as service as an aggregate. So we now have roughly $800 million of aggregate protection in excess of $3.54 billion. So we had both an excess of loss program as well as an aggregate program through to catastrophe bond.

I think from a pricing standpoint, your comment was spot on. We did see some modest pressure on pricing. I think a lot of that was driven by reinsurers kind of reevaluating their wildfire exposure in their models, but it was not a material move from a pricing standpoint. So we feel really good about placement this year.

And then just to remind you, we -- the fact that we renew 1/3 of our program every year, which further insulates us from any real fluctuations in reinsurance pricing year-to-year, so we feel good about the execution. And we use both the traditional reinsurance market and the ILS market to kind of optimize the execution of our placement. So overall, we feel good about the program.

With Florida, obviously, there've been a lot of stories around the upward development and some of the hurricane losses. Our recoveries over the last couple of years have been a bit more modest, I think, than others. So we'll see what the ultimate pricing is, but I wouldn't expect a meaningful variation relative to what we saw in the national program.

Operator

Our next question comes from the line of Amit Kumar from Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Two quick questions. The first question uses Page 21 of your supplement as a backdrop. If you look at the loss cost trends, severity is up 6%. Frequency is usually down in the 1% to 3% range. How should we think about, I guess, that trend line versus written premiums for the next few quarters?

Thomas Joseph Wilson
Chairman, President & CEO

Amit, let me drive an overview of how we establish the financials, and then Glenn can talk about the specific operations as to those. So we give paid numbers, and we have both -- we have gross, net, paid, incurred, case reserves. We slice and dice the -- our work on what is the right loss cost to put in the financials at some great length. And so we feel comfortable with the reserves we've established based on the trends that you see in paid and then the other trends we see in the other numbers. Glenn -- I know we've talked at some length about on physical damage in auto insurance. I assume that's where you're at. And we -- Glenn can talk about that component.

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

Tom, yes. So physical damage, as you point out, has been elevated really over the last year, and you see things across the industry, and we're no exception to it. It's run around 6, and it's for the quarter as well versus the longer-term trend of around 4.

One thing I think is important for a sort of context in the broader question you have around that relative to margins and to prices is that, that's really sort of 1 quarter of the overall auto loss trend. Because if you break it out physical damage coverages and injury coverages, that splits roughly half and half. And then each of those are impacted equally by frequency and severity, as you point out. And so really when you look at overall loss trends, 3 out of the 4 quadrants that I just described are performing at or better than expectations, and one is running hotter. So the overall loss trend is manageable right now, and you can see that in our combined ratio, and the fact that rates have been relatively modest. But we're clearly focused on the physical damage. And just a little color behind that. I know we talked about it last quarter -- is you look at the math and auto manufacturers have definitely increased the pricing of parts. You look at the trajectory, and some of this is complexity of cars and some of it is pricing choices. Because you look at the overall cost of cars and how it's accelerated over 10 years to buy a car in whole and the cost of parts, and the 2 trend lines are wildly different. The cost of parts have gone up dramatically faster than the cost of the car, and that's definitely impacting repair costs, which then create more total losses and higher physical damage expenses.

Amit Kumar
The Buckingham Research Group Incorporated

Got it. That's very helpful. The only other question is -- and this might be an easy answer here. I was looking at the expense ratio for Allstate brand, homeowners and auto. And there seems to be some sort of variability in Q1. The Q1 number seem to be down versus Q2, 3 and 4. Is there -- how should I think about that? What exactly is causing that expense ratio to be slightly down in Q1 versus the remaining 3 quarters?

Thomas Joseph Wilson
Chairman, President & CEO

Amit, I wouldn't really look at the expense ratio by quarter and determine -- and draw a trend line from 1 quarter to next because there's stuff that goes in and out. Every quarter, we make adjustments, agency bonus and there's all kinds of different accruals. So I would note that. Glenn can talk about the work we're doing on expenses, which is in an environment where you're running, let's just take home, auto at 90 combined ratio, homeowners at 92, and regulated environment on price and some even modest cost pressure. You want to maintain your margins as well as you can. So you look at all things you can do to control those margins, including expenses. So Glenn might want to talk about some about what we're doing in expense management.

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

Yes. We've been very focused on expenses. As Tom said, you look at where you are and what leverage you can pull. And I think the greatest value we can provide customers is to deliver the product with lower expense. So we looked at our supplier management. We have lot of really good work going on with our procurement.

From an operational standpoint in our claims area, the team has moved materially on their expenses over the last year plus. They're down 500 plus people in terms of the overall operation and being able to manage in spite of our growth and the frequency trend creating kind of a flat claims reported trend. And we're looking at -- as we go forward, we're looking at ways that we can manage expenses more effectively with our agency force as well through things like providing services to our agency force. So expenses are a significant focus for us.

Operator

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

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

So my first question is around the increased use of telematics. So I think we all intuitively understand that it should also result in some improvement in the loss ratio over time. But can you maybe talk a little bit about whether you see an impact from greater use of telematics on the expense ratio, whether through more efficient claims handling or more efficient customer acquisition?

Thomas Joseph Wilson
Chairman, President & CEO

Yaron, let me go up a minute and then Don can talk about some of the things we're doing at telematics. Glenn, maybe you can talk a little bit about claims.

So what I would -- I would rephrase your question a little bit if you give me the space to say, it's really about Integrated Digital Enterprise. So it's using data analytics technology and process redesign to improve our effectiveness and our efficiency. So we've talked at some length about QuickFoto Claims. So -- no -- 6 pictures from customers, payment hours, night and day, no more 937 drive-thrus, fewer auto adjusters. So there's a variety of work we're doing around the company to build an Integrated Digital Enterprise. One part of that is telematics, and that's on getting information, accumulating information. I don't think that, that's reduced our expenses. In fact, we've been investing heavily in telematics for the last 9 or 10 years. And each year, we invest more because we see it adding more value to our customers. And Don can talk about the overall view of why we're doing telematics and the benefits to our customers in our company. But maybe, Glenn, do you want to start with IDE and then, Don, in telematics?

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

Yes. So we really think there's a lot of opportunity going forward with telematics as you think about operational improvements. So for one, and this is a go-forward, this is not the inputs today, but you look at the opportunity to report losses in real time. So eliminating the need for a first notice of loss, you have instantaneous notification. And then opportunity is there in the, I'll call it, relative near term. This is not a far-out proposition. And then we're already working with -- looking at information for liability determination and helping us understand what occurs in an accident, which can make you both more efficient and more accurate in what you're doing.

But one other piece that I don't think was in the question, but I think it's really important, is we have a materially higher promoter score when people are using telematics. So you think about retention, when you think about the interest that people have and the feedback they're getting to become better drivers and just the instant thing with Allstate, it makes a big difference when we have those signed up in telematics.

Dogan Civgin
President of Service Businesses - Allstate Insurance Company

Yes. So let me talk a little bit about the Arity side of it. So we talked last month about the value of telematics and how it can be used in different ways, and I think 2 conclusions from that. The first is we firmly believe that it will be the better way to price insurance because we have a better understanding of risk. I think the second thing is the access to that telematics data also allows us to understand driving behavior, which is an important component of adding value back for customers, both our customers and our partners' customers. So we have been investing in Arity. You mentioned the expense side of it. Arity is running at a very small loss at this point, but a large part of that is not just investment in things that we know how to do today, but it's product development as well. So we're investing in things that will create more value in the future for our customers, and that's probably roughly half of the investment we're making on the product side.

Mario Rizzo
Executive VP & CFO

We have just under 15 million connections with customers today. I think we talked a little bit about how much data we're collecting, how quickly we're analyzing that. We have analyzed roughly 115 billion miles. And what that allows us to do is, again, not only price the insurance more accurately, but provide value for our customers. So if you look at our relationship with Life360, through that connection, we're able not only to give them safe driving tips for their customers, but also get them personalized insurance offers from a variety of different carriers. So it is an investment. It offers lots of opportunities in the future around pricing and the ability to serve customers better, make them safer drivers.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

I guess one other very quick one. Why was the reclassification of pensions -- why did it impact the loss ratio as opposed to the expense ratio?

Jesse Edward Merten
Treasurer

Yes. That piece, think about the department loss ratio, slight expense, which is related to the people that sell claims for us, so it impacts part of the pension expense as opposed to the loss ratio.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

So this pension expense impact only impacted claims people as opposed to the underwriting people?

Jesse Edward Merten
Treasurer

No, no, no. It gets allocated across both claims and underwriting expense. So the fact that there's people embedded within our claims expense ratio, that's where the loss ratio benefits from that change.

Operator

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

Michael Wayne Phillips
Morgan Stanley, Research Division

So a question -- kind of stepping back at a high level. You guys fully measure a lot of things. I guess I'm curious if you measure full traffic in and out of your brick-and-mortar stores that are -- throughout the country. And if you do, what's the kind of the number of people coming in and out of those stores? And if you do, how has that changed today versus if you look at back maybe 10 years ago? Are more people coming into using that or less?

Thomas Joseph Wilson
Chairman, President & CEO

I can't give you -- this is Tom. I can't give you a number 10 years versus today. And I would say that you have to split that into 2 components. What do they come in for that they want to come in for? And what do they come in for because you make them come in for?

And so for example, if you have a bill that's late and you can make somebody come in and drop it off at your office or you can give them a credit card option and they can call and put down their credit card and not have to drive anywhere. So in general, our focus is to be there for our customers when they want us to be there for them and to use faster, more digital technologies once they don't want it.

I do think what you're seeing as a trend over 10 years, lot more people are comfortable using digital stuff. The capabilities are better. The -- your phones are better, right? And so we're leaning in heavily to that. Whereas we used to make people come to our drive-thru claim places to get their car looked at, we now have them send us 6 pictures. So that said, there are plenty of things that people do want to come into the office for. But it depends on the office and the type of customer. So we try to be there for them when those people want to be there. So some agencies hold events for their customers. They go to charity events there or they do planning processes or they have -- they go out -- they don't go to the office, but the agency goes to the school and talks about distracted driving. So I would say, in general, our effort, though, is to try to do as much as we can digitally, if the customer wants to do digitally, so it lowers our costs and improves our speed. And to the extent they want to do it in person, we do it in person.

Operator

Our next question comes from the line of Michael Zaremski from Credit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

In regards to the pension accounting changes, can you clarify how that helped the underlying combined ratio? And does it change how we should think about the guidance range as well?

Thomas Joseph Wilson
Chairman, President & CEO

I'll let Mario answer how it went to the combined ratio and the guidance, but I will just say on the guidance. We knew we are making this change when we did the guidance. The reason we made this change really is the trend towards financial reporting is fair value, whether that's -- the amount your equity portfolio goes up or down in the quarter, goes through net income that used to be unrealized capital gains and didn't go through net income. And so this is just another step along the way of going to a sort of fair value on the overall results.

In addition, it was kind of choppy the way it was before with pension settlement charges, and this just spreads it out over a longer -- or not. It spreads it out over time. You don't get these quarterly bumps for settlement charges when people decide they want to retire, which tends to be at the end of the year. So you're kind of dancing around in the fourth quarter is where they have the settlement charges. This just puts it all on fair value, puts us all in the same basis. Mario, do you want to talk about the [combined ratio]?

Mario Rizzo
Executive VP & CFO

Yes. Maybe I'll just give you a little bit of color on -- really, when you think about pension expense, I would break it out into 2 pieces. So the part Tom alluded to, the fair value component, which is really just the change in the valuation of planned assets and liabilities quarter-to-quarter. That runs through the income statement after net income, but it gets recorded below the line, so it doesn't affect adjusted net income.

The portion of pension expense that is in adjusted net income is really the period-specific pension costs, things like benefit accruals for that particular period, interest costs, those kinds of things. Those are still in adjusted net income.

When you look at the differences, as I mentioned during the presentation, when you look at the difference between kind of the previous method and the current method of pension accounting for the first quarter of 2019, and we provide you a table in the 10-Q that gives you the difference in cost, in total for the corporation, it was worth about $21 million in lower cost in the quarter. Not all of that is Property-Liability. A portion of it is. That's where you get to about the 0.2-point impact in the quarter. So I would view that as a reasonably small impact. And to Tom's point, we knew we were going to make the change when we established the guidance, so I don't think it really has an impact on how we think about the outlook for the combined ratio.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. That's very helpful. And my last question is regarding Slide 13. You show your net PMLs have been reduced a lot over time. And so directionally, should your catastrophe load also be lower than your, let's just say, 13- or 14-year long-term historical average? And Tom, I believe you touched on this potentially earlier in your answer to -- about homeowners returns.

Thomas Joseph Wilson
Chairman, President & CEO

I think what it does do is it lowers the amount of capital you carry for catastrophe events, but I would -- mathematically, the probable maximum loss is really driven by large individual discrete events like a forceful hurricane or some large set of events, which are low probability. That's when you're carrying all that capital for just in case something really bad happens.

The -- when you look at the catastrophe load on a quarterly basis and say, how many hailstorms do we have, how many freezes do we have, that's really driven more by the weather, and that's not -- that's factored into -- that doesn't reduce capital as much because those things tend to go. So I wouldn't automatically go from lower PML to go to that chart we have in the supplement that shows percentage of premiums on cap and say that should be coming down, too, because what really drives that is just the weather.

Now we do a bunch of things around that to make sure it's less, right? So we do -- we have house and home, where we age rate groups. We do a whole bunch of things to manage that number, as Glenn said, because we're accountable for the total combined ratio. But I wouldn't translate lower PML, lower capital, therefore, lower percentage every quarter.

Michael David Zaremski
Crédit Suisse AG, Research Division

So if I could follow up then. So do you -- from us looking from the outside in, should we just use your very long-term historical cat load as a guide when we are making our projections?

Thomas Joseph Wilson
Chairman, President & CEO

Yes. I would look at the long-term percentage of -- just say that cats are not predictable. And so I would come back to, on a rolling basis -- Steve's in it -- Glenn said we've made money every quarter for -- except for 7 years -- except for one.

I think like in homeowners, you just got to look at it on a longer-term basis. It's a 1-year or 3-year basis, and we ran -- you want to run a combined ratio where you're getting a fair amount of spread on it. We don't -- those -- some of our competitors run combined ratios substantially higher than us in homeowners. We don't think that's appropriate because of the cap we have to put up, and you don't get a lot of investment income on homeowners. So you should look at us and assume we can have a reported combined ratio that generates an underwriting profit. And Jess talked -- showed you what we think those should be, and that's by state. Obviously, in total, it can be higher than that by state because we have covariance that's not showing in that chart. So when you see the one that says 88, we could be higher than 88, still get a good return on the whole company because we have covariance in it.

Operator

Our final question comes from the line of Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I just want a quick one, following up on Amit's question on auto accs and severity a little bit. As more cars hit the road with automatic emergency braking and weird gadgets in the side view mirrors and whatnot, is the upward trend in severity a permanent part of what we're going to see happen on physical damage for the foreseeable future?

Glenn Thomas Shapiro
President of Allstate Personal Lines & Director

Yes. So thanks for the question, Josh. Yes, this is Glenn. I would say that there's no question the complexity of cars is getting greater, and we've seen the increasing cost of repairs and in the cost of parts. Now theoretically, you get 2 sides of that equation, that all of those things you just mentioned should help avoid some accidents. We see some evidence of that in some places. And -- but frankly, the broader trend of lower frequency is more driven by the number of miles driven than it is by that. But over time, you'd expect some frequency benefit as the car part increases the percentage of cars that have loss avoidance capabilities and an increase in the cost to repair those cars.

So I do think there is the potential for a long-term trend that you would have the cost of the newer cars making up the bigger portion of the overall cost to repair. But it's why I think we need to work with manufacturers and look at the cost of parts because as I think I said last quarter, the percentage of total losses continues to go up. And I don't think it's good for society or the industry as a whole to have cars become disposable to where, if it's in an accident, you throw it out and you get a new one. I think there's benefit to be able to come up with more attractive and cost-effective ways to repair these cars.

Thomas Joseph Wilson
Chairman, President & CEO

Thank you all. So our strategies profitably grow market share in our protection products, making sure we have good strong results. We had a good strong quarter, and we'll continue to work on behalf of our shareholders by innovating and growing market share. Thank you very much. Have a great quarter.

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