S&P Capital IQ

CONTENTS

The Allstate Corporation NYSE:ALL

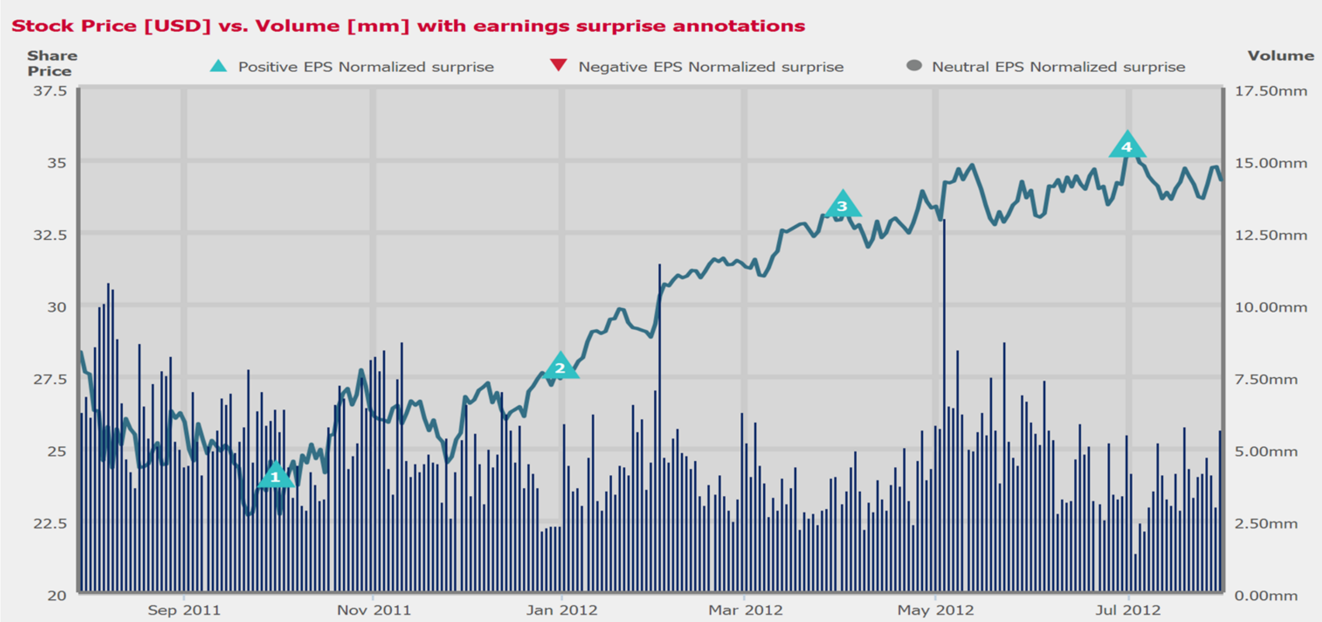
FQ3 2012 Earnings Call Transcripts

Thursday, November 01, 2012 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2012-			-FQ4 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.12	1.46	▲30.36	0.94	4.49	4.46
Revenue (mm)	6728.59	6697.00	▼(0.47 %)	6682.45	26739.78	27171.19

Currency: USD
Consensus as of Nov-01-2012 12:23 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2011	0.12	0.16	▲1 33.33 %
FQ4 2011	0.96	1.48	▲2 54.17 %
FQ1 2012	1.10	1.42	▲3 29.09 %
FQ2 2012	0.57	0.87	▲4 52.63 %

Call Participants

EXECUTIVES

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Presentation

Operator

Good day, ladies and gentlemen, and welcome to The Allstate Corporation Third Quarter 2012 Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference, Mr. Robert Block, Senior Vice President, Investor Relations. Sir, you may begin.

Robert Block

Thanks, Matt, and good morning, everyone. Thanks for joining us today for Allstate's third quarter earnings conference call. First, Tom Wilson, Steve Shebik and I will provide some color on our results for the quarter. And then we'll go into a question-and-answer period. Also on the call are Don Civgin, Head of Allstate Financial and Insurance; Judy Greffin, our Chief Investment Officer; Sam Pilch, our Controller; and Matt Winter, Head of Auto, Home and Agencies. Don Bailey, who leads the Emerging Businesses, will not be able to join us today since he's on the East Coast a result of Superstorm Sandy.

Last night, we issued our press release and investor supplement and filed our 10-Q for the third quarter. We also posted a slide presentation to be used in conjunction with our prepared remarks. These are all available on our website.

Beginning with Slide 1, this discussion may contain forward-looking statements regarding Allstate's operations. The actual results may differ materially from these statements, so please refer to our 10-K for 2011, our 10-Q for the third quarter 2012 and our most recent press release for information on potential risks. This discussion will contain some non-GAAP measures for which there are reconciliations in our press release and on our website. And I will be available after this call to answer any follow-up questions you may have.

Now I'll turn it over to Tom for his perspective on our performance.

Thomas J. Wilson
Chairman & CEO

Well, good morning. We appreciate you spending time with us today.

Before we discuss results, let me say a few words about Hurricane Sandy, which I know personally affected many of you. First, I hope you all are getting your lives back together. As you know, this was a massive storm affected most of the Eastern half of the country. If you look on Slide 2, you can see the breadth of that.

Putting it in comparison to other events, this is at least twice the breadth of Hurricane Katrina. The good news is that the wind speeds were substantially lower than Katrina and more like last year's Hurricane Irene. In fact, the winds speeds were about 2/3 of Katrina. And as you know, the damage is exponential as that speed goes up. And while it's, of course, too early to call ultimate damages, several modelers have put out insured loss estimates, Eqecat's at $5 billion to $10 billion, AIR's at $7 billion to $15 billion, with economic losses at twice that amount. If the storm's damage is over $8 billion in insured losses, that will make it the fifth-largest hurricane in U.S. history.

Of course, a lot of the damage at this point would appear to be caused by flooding. That is covered by your auto insurance. As you know, the federal government provides flood insurance, and it's typically not covered by people's homeowners insurance.

And of course, in these times of trouble -- that's when our company, Allstaters, do great work on behalf of our customers. We have 1,100 catastrophe claim adjusters out in the field as we speak; another 500 at our service centers. We have 24 mobile claim centers. We're reaching out to customers. We're doing advertising. We're walking the neighborhoods. We are very proud of the fact that we are either among the first, if not the first, to be there for our customers, and it's sort of a point of pride for us. We're out there helping them find a place to live, get food and clothing, assess their losses. And Allstaters really do an amazing job of providing for the needs of our customers, being empathetic and supportive at this time.

As you know, our customer focus is central to our strategy. In fact, we've just got the J.D. Power Auto Claims Satisfaction results this week, and our overall satisfaction on auto claims increased significantly. We're now in the high satisfaction tier, above the industry average and several other well-known insurance brands.

Now we all want to know, of course, how this storm -- much this storm will ultimately cost us, and it's obviously too early to estimate the impact of that storm. However, the catastrophe is not expected to have a material impact on our overall financial condition. Obviously, at this time, our focus is on our customers, not our monetary losses. Ultimately, of course, we do provide an estimate for cat losses in 1 month if it surpasses $150 million. We typically do that by the third Thursday of the following month. Because this event occurred at the end of a month and it involves such extensive damage, we may not have enough information to develop a credible estimate by November 15. This way that Thursday falls is really 15 days after the end of the month. But as soon as we have an estimate, we'll put one out.

Now let's move on to discuss results for the quarter. I'll focus my remarks on our performance relative to our 2012 priorities. And then Bob and Steve will cover the quarterly results in greater detail.

So moving to Slide 3. Our strategy, of course, is to provide unique products to each of the 4 customer segments in the marketplace, which you can see on the top there, and it is working. The Allstate brand serves those customers who prefer to purchase competitively priced branded products and want local advice and counsel. In this business, we've introduced several new differentiated products including Claim Satisfaction Guarantee, Drive Wise, Good Hands Roadside and House & Home.

In the third quarter, premium and unit growth continued to be impacted negatively by our efforts to improve homeowner returns broadly across the country and our actions to improve profitability in a few large auto states, which as you know, we started last year. We did see positive premium growth in total for the Allstate brand as homeowners, Emerging Businesses and standard auto outside of New York and Florida all contributed to that increase.

Additionally, Allstate Financial's new issued life policies sold through the Allstate agencies to the customers in this segment increased as well. And of course, we continued to look for ways to improve the growth trajectory for standard auto, one of our core lines, identifying market opportunities to expand homeowners and Emerging Businesses and then support our agencies so that they can grow their business profitably.

In the self-directed segment, that prefers a branded experience, that's served by Esurance, that's on the lower right. Since they reported last October, Esurance has exceeded our growth expectations, with policies in force increasing 22% since the beginning of this year. The GAAP combined ratio remained elevated, as one would expect, given the amount of new business we're writing and the way the accounting works for direct businesses. We are closely watching the loss ratio since maintaining auto profitability is one of our core priorities.

Our progress is also evident in the advice in brand neutral customer segment, that's up top, served by Encompass. The growth and profit trends for that brand are also positive.

If you move to Slide 4. Let's review our financial performance for the third quarter. On a consolidated basis, we generated $723 million in net income and improved underlying margins and lower catastrophe losses while growing premiums. Operating income of $717 million converts to $1.46 per diluted share, and that's our best quarterly results in 5 years.

Our book value per share grew to $42.64 per share, that's 22.4% better than the third quarter of 2011. And lastly, we produced a return on equity of 13.6% and 15% on a net income and operating income basis, respectively. That is on a trailing 12-month basis.

Now I recognize we set a goal of 13% operating income return by 2014. Keep in mind that while we make good progress on improving the profitability of the business, the weather has been fairly good over the last 12 months, so there's more work to be done before we feel like we've achieved that goal.

We also established 4 priorities for 2012, and we are on pace to achieve all of them. Maintaining auto margins is critical. The underlying combined ratio in the quarter was 93.7, that's an improvement from the third quarter of 2011. The homeowners' underlying combined ratio improved 7 points as rates continue to work into the P&L and then the weather remained relatively benign and the benefit of our underwriting actions. This is a result of 5 years of hard work to reposition this business.

Annuity returns remained relatively flat and the reduction in contractholder funds was lower due primarily to the low interest rate environment. Going forward, we'll continue to look for opportunities to accelerate that reduction.

Property-Liability insurance premiums grew 5% from the third quarter of 2011, largely due to the acquisition of Esurance. Both the Allstate brand and Encompass produced positive premium growth rates in the quarter. And at customer segments served by the Allstate Agencies, however, auto and homeowner policies, declined. Reversing this trend is a key priority for Matt's team. But Don Bailey's team has done a nice job of repositioning Encompass and growing the roadside business with a new product. Good Hands Roadside now has over 750,000 members. We actually changed the disclosure in the investor supplement to see the policies in force in a slightly different way this quarter.

The Allstate Financial team, led by Don Civgin, is growing life sales through Allstate Agencies and the Benefits business.

Judy's team continues to proactively manage the investment portfolio, which led to solid total return performance of 2.4% in the quarter and 6.3% through September. Net investment income of $940 million declined 5.4% from last year's third quarter. And that's primarily due to reduced Allstate Financial liabilities, lower yields, which of course we're all familiar with, and then limited partnership results were down a little bit this quarter as well. The portfolio net unrealized gain increased in value during the quarter to $5.7 billion at the end of September.

Now from a capital utilization perspective, we repurchased $153 million of our stock, and that's at a slower rate than in the previous quarter. As we said, in the third quarter as we moved through cat season, we tend to slow that program down a little bit.

We feel good about the results for the year but also recognize there's a lot more work to be done. So let's hear from Bob and Steve.

Robert Block

Thanks, Don. Let's take a closer look at the details for Property-Liability and Allstate Financial for the third quarter. Beginning with Property-Liability on Slide 5, we show both the top line and combined ratio results. Overall written premium grew 5% from the third quarter 2011 to $7.06 billion, primarily due to the acquisition of Esurance. The growth rate increased from the second quarter 2012 as both the Allstate and Encompass brands also contributed to the positive result.

Looking at the results by line, Allstate brand standard auto declined by 0.2% from the third quarter 2011, and it was similar to the second quarter 2012. Excluding New York and Florida, the 2 states where we have implemented significant profit improvements over the last 18 to 24 months, Allstate brand standard auto grew by 1.4%.

New issued applications of 460,000 remained slightly below the prior year, but we're at the average level produced over the last 6 quarters, which ranged from 451,000 to 472,000. The retention ratio remained at 89.0%, down 0.10% from the third quarter 2011. Policies in force declined sequentially as the level of new business was not sufficient to offset the renewal losses

Allstate brand homeowners' net written premium of $1.69 billion increased 3.2% compared to the third quarter of 2011. The favorable impact of rate changes on average premium more than offset the decline in units. We continued to see great changes in order to achieve our stated return goals.

In addition, we are rolling out our new product, House & Home, now in 17 states, including 5 states that rolled out in the month of October.

Encompass continued to show positive results in both premiums and units, with increases over prior year of 5.3% and 3.8%, respectively. Esurance contributed $282 million in premiums written during the third quarter and increased units sequentially to 962,000, a 22.4% gain since the beginning of the year.

On the bottom half of the slide, we provide the combined ratio results for Property-Liability and by brand on a recorded and underlying basis. The recorded combined ratio for Property-Liability was 90.2, significantly better than the prior year due primarily to lower catastrophe losses and an improvement in the underlying combined ratio.

Year-to-date September, the underlying combined ratio was 87.4 or 1.5 points better than prior year and below the bottom of the outlook range we provided at the beginning of 2012 of 88 to 91. If we matched the underlying combined ratio we recorded in the fourth quarter of last year of 90.7, it would put us in the lower end of that range. Now this is not a prediction or a forecast, just creating some context for why we didn't adjust the range at this time.

During the third quarter, we completed our annual comprehensive review of the discontinued lines and coverages reserves. We made some minor adjustments to the reserves for an impact of $42 million.

The recorded combined ratio results by brand indicates significant improvement for both the Allstate and Encompass brands due primarily to reduced catastrophe losses. The underlying combined ratio also improved for the Allstate brand and Encompass. For Esurance, the recorded and underlying combined ratios remained elevated.

On Slide 6, we provide charts detailing loss trends, rate changes and combined ratio for Allstate brand's standard auto. As shown in the upper left-hand corner, after increasing over prior year in the second quarter, gross frequencies for both bodily injury and property damage declined 1.2% from the third quarter 2011.

In the upper right-hand chart, the calendar year paid severity results for property damage showed a little acceleration from second quarter, increasing 3.9%. Bodily injury calendar year paid severity rose to 6.8% increase over the third quarter of 2011. The bodily injury severity tends to be volatile from period to period, and the mix of state and report years contributes to it. But over a 2-year period, the increase is in line with inflationary factors. There's some pressure on the most recent report years, primarily in New York and Florida. However, the overall loss trends remained well within our pricing actions.

In the lower left hand chart, we provide the approved rate changes for the last 4 years. For the last 4 quarters, we've averaged about 3% in standard auto rate changes. And the lower right-hand chart displays the combined ratio trends since the beginning of 2010. And over the last few years, the combined ratios remained very consistent in the mid-90s range.

Slide 7 looks at the underlying combined ratio trend on the top of the page and the underlying margin components on the bottom of the page for standard auto. In the top chart, you see that we've averaged in the underlying combined ratio of 95.1 over the last 4 quarters. Now on the bottom the page, you can observe that the average earned premium, which is the red line, has remained above the average losses line, shown in blue, meaning that the margins are getting a little better each quarter. Maintaining auto margins remains a top priority for us.

On Slide 8, we provide similar statistics for homeowners. In the upper left, we have approved rate changes for the last 5 years. And over the last 4 quarters, we've received approvals for almost 7% rate increases on a countrywide basis. We will continue to seek needed rate changes in order to hit our return objectives for this line of insurance.

In the upper right, loss cost trends, excluding catastrophe losses, are displayed. For the third quarter, frequency decreased 11.4%, while paid severity increased 5.8%. These results led to a reduction in the underlying combined ratio of 7.1 points, as shown in the lower left. We continue to believe that about 1/2 of the improvement in the underlying results is sustainable and 1/2 of the results of the milder weather.

On Slide 9, we provide -- or Slide 9 provides a better look at the underlying loss trends for homeowners. The top chart gives the underlying combined ratio and one can observe the improvement we've achieved in the last several quarters.

On the bottom, we display the trends for the average earned premium and average losses over time. The trend for the average earned premium, in red, reflects the favorable impact of rates increasing steadily since 2010. The trend for losses, in blue, was far below the prior year's and gives rise to our hesitation to take full credit for the margin improvement we've enjoyed this year. That said, improving homeowners' returns is a priority for 2012, and we have been successful thus far through the first 9 months.

Now turning to Allstate Financial, where we continued to shift the focus to underwriting products and away from spread-based ones, the results reflect successful execution of this strategy. Total premiums and contract charges of $563 million increased 2% in total and 3.6% for underwritten products. Allstate Agency life unit sales contributed to this results, increasing 6.9% over the third quarter 2011.

Consistent with the strategy of reducing spread-based products, contractholder funds were reduced by $722 million from the second quarter and $2.2 billion from year end 2011. Given the low interest rate environment, we've not made as much progress in reducing annuity liabilities as we would have liked, and we continued to explore a variety of options to execute this strategy.

Net income for Allstate Financial was $131 million for the third quarter, down $61 million from the third quarter 2011. The primary reasons for this reduction were realized capital losses in 2012 versus realized capital gains in 2011, along with lower operating income results. Last year, we executed a sales program designed to harvest gains accounting for much of the difference.

Operating income was $97 million for the quarter. During this quarter, we completed our comprehensive review of assumptions for deferred policy acquisition, or DAC, deferred sales inducement costs and secondary guarantee liability balances. This resulted in a $27 million pretax charge to income. In 2011, we conducted this review in the first quarter of the year, resulting in a $6 million pretax charge to income.

Looking at the operating returns by line, life insurance declined 2.2 points to 9% from year end 2011, due to worse mortality experienced in the last several quarters and the impact of the annual DAC unlock study. Accident and health continued to produce solid returns at 16.6% as of September 2012.

With that, I'll turn it over to Steve.

Steven E. Shebik
CFO & Executive VP

Thanks, Bob. We continued to proactively balance portfolio yield and return objectives in this challenging low interest rate environment, delivering strong investment results with a total portfolio return on a GAAP accounting basis of 2.4% for the quarter and 6.3% to the first 9 months of the year.

On Slide 11, you can see longer term trends in the composition of our portfolio. We ended the third quarter at $93 billion in amortized cost and a fair value of $99 billion, reflecting improved valuations, which along with portfolio income and improved underwriting cash flows from our Property-Liability business, more than offset the ongoing reduction from Allstate Financial's spread-based business.

The chart on the left-hand side chart of this slide helps to illustrate the results of our proactive steps to enhance the profile of our portfolio from a risk and return perspective. Note that the drop in the portfolio's amortized cost resulted primarily from our planned reductions in Allstate Financial's liabilities.

As we headed into the financial crisis, we proactively reduced financial sector and real estate related exposures while increasing the liquidity of the overall portfolio. Coming out of the crisis, we have favored the strong fundamentals and stability of credit, including high yield, over public equities.

During the most recent quarter, we opportunistically reduced risk by selling $722 million of structured securities, realizing a loss of $119 million. The securities increased in value over the course of the year, justifying the sale into a strong market. Collectivity, these actions have resulted in a strong, well-positioned portfolio.

We have been proactively managing interest rate risks by optimizing our fixed income portfolio's position on the yield curve, focusing on intermediate-term securities. This will reduce reinvestment risk and lessen the sensitivity of our portfolio's value to increases in interest rates.

On the right-hand side of the slide, you can see the results of these actions in a scheduled maturity profile to the shift away from the due-after-10-years category. We are contemplating reducing our interest rate risks in our Property-Liability portfolio further by selling additional long-dated securities and reinvesting shorter on yield curve. We expect gains to be realized in the sales and the portfolio yields to decline as these sales and reinvestments are executed over the next several quarters.

If you turn to Slide 12, it highlights our portfolio income and yield trends. For the third quarter of 2012, net investment income was $940 million and total portfolio yield was 44.3%, below both the prior quarter and third quarter of 2011.

You may recall that we prospectively changed our classification of equity method limited partnership results to net investment income when realized capital gains at the beginning of the year, which brought us in line with the reporting practices of other peers.

Although investment income on limited partnerships of $22 million is below the prior year quarter, this income is $177 million higher on a year-to-date basis. The increase reflects the change in classification, as well as an improvement of $50 million in limited partnership performance.

Excluding limited partnership results, the portfolio yield was comparable to last quarter and the third quarter of 2011.

On Slide 13, you can see that we realized losses of $72 million in the third quarter of 2012 compared to a realized gain of $264 million in the third quarter of 2011.

Our portfolio management actions and other trading activities generated approximately $24 million in net trading losses, including the $119 million loss from the sales of structured securities I mentioned earlier.

Impairment and intent write-downs are $46 million and continued to trend significantly lower than prior year periods. Derivative results in the current year reflect reduced usage as we are managing more of our rate risk in the cash market in portfolio positioning and yield curve. In the third quarter of 2011, interest rate derivative valuation losses reflect the significant decrease in rates in that period.

We finished the quarter in a strong capital position, as shown on Slide 14. Shareholders' equity of $20.8 billion increased $2.5 billion from year end 2011. Statutory surplus rose to $17 billion and deployable assets of the holding company level reached $2.3 billion at the end of the third quarter.

We continued to buy back our stock, purchasing $153 million during the quarter. That leaves $166 million as of quarter end on our current $1 billion buyback authorization.

Our book value per share came in at $42.64, and the strength of our operating performance improved portfolio valuation and active capital management.

Now let's go to the question and answer session.

Robert Block
Okay, Matt, if you can start the Q&A, please.

Question and Answer

Operator

[Operator Instructions] Our first question is from Josh Stirling of Sanford Bernstein.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

The question I would ask would -- recognize since you can't comment on an actual estimate, of course, it's way too premature. But you are getting reports of first notice of loss. You're out there in the field talking to customers. You have some sense of the volume of the storm. I'd love to get a sense from these operating metrics sort of where you are, you've -- say, in perspective in relation to Hurricane Irene last year. And then similarly, you probably are starting to get a sense of the mix and composition of the claims that you're actually going to have to adjust. And I'd love to get a sense especially when we think about severity going forward. Is this going to be driven by lots of large total unit losses or are you going to see more sort of modest -- far many, but may be more than previously, but sort of many more sort of smaller losses that are sort of damage to ancillary structures and things like that?

Thomas J. Wilson
Chairman & CEO

Josh, this is Tom. You're correct in saying it's way too early. Even on loss counts, it's a little difficult because sometimes people have cell phones; they can get access to it. Sometimes they don't. I can tell you, we're very busy. We also do, as you know, flood adjusting for the federal government where right through on the flood, we're one of the bigger handlers to the program as well. So we take all of those claims in. Anybody calls this customer, we go out and see him. So it's really too early to tell on either the volume, the mix or the severity. What I can tell you is when we do our estimate, we'll try to give you as much information as we can at that point in time. I can tell you that the -- from a risk management standpoint, we are down in policy counts in all of the affected areas by a reasonably substantial amount. And if you're interested in that, Matt can give you some are details on it. But we are -- the actions we've taken over the last 5 years in places like New York, New Jersey, all up along the East Coast, have produced the policy counts we have there, in the 10% to 30% range. And that will obviously impact what our losses are relative to what they would have been. But what you really want to know is what are they going to be, and I can't give you any more clarity than that.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

I certainly understand. The investors, I think, at this point are sort of obviously dealing with modeling firm estimates. I think you guys are sort of sophisticated users of the models, and you've got a lot of your own data and your own perspective over time. I'm wondering what sort of -- to use the phrase, sort of, "known unknowns" model errors and sort of historic sort of biases that you think that historically perhaps we've seen that you guys might be watching for as you handicap the estimates themselves? And one topic of conversation, I think that people are curious about is whether this has a possibility of being something like Ike, which ended up going further inland and ended up driving sort of surprising levels of losses with what would have been perceived to be modest wind further inland than typically models would have suggested at the time.

Thomas J. Wilson
Chairman & CEO

Josh, maybe I can give you a comment on the models and then a suggestion maybe on how I can help you sort out what you're trying to get as you look to impact on us. If -- we do obviously have our own models. We buy all the models from everybody else and we have our own policy data actually loaded into that so we have a wide range. Matt and his team have done a number of scenarios. It's a really wide range. So that number could be low; it could be higher. What I think we could do to give yourself some comfort as to how big it could be would be look at -- go to the website and put in gross losses into the reinsurance section. It's got the interactive model, which will tell you what the net ought to be. And you can see that at certain levels our reinsurance programs kick in, which caps our exposure. Oh, Bob tells me it's not interactive. Sorry. I guess, the interactive part will be you'll have to sign in. I thought we're a little more sophisticated than that, Josh. Sorry. But Bob can help you.

Steven E. Shebik
CFO & Executive VP

We can help you out.

Operator

Our next question is from Ian Gutterman of Adage Capital.

Ian Gutterman
Adage Capital Management, L.P.

I guess, first time, when I look at the auto results, obviously very good. I think you said it was a 93.7, I think, accident year. But if I add on it to the normal caps, a couple of points, that's high 95s, which again, is a solid result. But I'm wondering can that get better? Can we get that -- in the past, you've obviously seen low 90s, but even in 94, 95, is that possible given rates are starting to improve? Or is 96 kind of the best you can do in the current rate environment?

Thomas J. Wilson
Chairman & CEO

First, I just want to give one point of clarification. The information we provided is calendar year, not accident year. So...

Robert Block

The underlying to that.

Ian Gutterman
Adage Capital Management, L.P.

The underlying, sorry.

Thomas J. Wilson
Chairman & CEO

What the underlying says...

Ian Gutterman
Adage Capital Management, L.P.

But the underlying to those [ph] cats, I took the underlying and added 2 points of normal cats to it.

Thomas J. Wilson
Chairman & CEO

Okay. The way we look at the auto business is it generates really good returns for us, so return on capital at that level -- we've shown some slides before -- depending what you want to assume in terms of capital levels, is in the 20% range, plus or minus. That's a really attractive return on capital. We'd like to grow that business at those kind of returns. So I would rather see us grow it and maintain auto profitability than squeeze a few extra dollars out of margin.

Ian Gutterman
Adage Capital Management, L.P.

That actually went into my follow-up, which I was going to ask. How is the outlook for that? I believe there was an internal memo that hit one of the newswires that suggested you're broadening your targets and maybe -- but trying not to seem to be a little bit more optimistic about growth going forward, and certainly with competitors, some of your big competitors having to chase rates to improve their profitability back to what it used to be. It would seem maybe you're in a little bit of a sweet spot here?

Thomas J. Wilson
Chairman & CEO

Let me maybe provide you an overview on growth in total, and then Matt and Don can give you some more detailed perspectives on both the Allstate brand, Esurance and Allstate Financial. I think you have to think about it in total as you think about our strategy. So first, our strategy focused on these 4 segments have competitively differentiated products in those segments targeted to those customers. The largest segment, as you point out, is the advise and brand, focus one, that's served by the Allstate Agencies. The overall policies in force are down there, which is largely as a result of the homeowners' actions we've taken, which was intentional on our part to improve returns in that business. Along with that, standard auto is down a little bit partly due to the homeowners, partly due to New York and Florida. Matt can talk about what his opportunities are there to grow. I think the biggest opportunity is to improve our customer retention, because these new business levels are kind of running about where you expect them to be. We have expanded the disclosure. As I've mentioned earlier, you can see Good Hands Roadside, which serves that segment largely, is up substantially. But we don't count it as a policy since they don't pay us until they actually use it. The advice and brand neutral segment that's served by Encompass, that independent agency is up slightly. We need to recapture some lost market share there. Esurance is that self-served branded segment. We're growing it a rate as fast as we're comfortable with. And then Allstate Financial is growing the life policies sold to that lower left-hand segment and our Benefits business. Matt, do you want to make some comments more specifically to the -- I guess, you are up to standard auto so we could zoom in there.

Matthew E. Winter
President and President of Allstate Insurance Company

Sure. It's Matt. I'll comment a little bit first on the some of the drivers. So Tom mentioned our 2 primary drivers that have impacted growth have been our homeowners' return improvement actions and some of the auto profitability issues in New York and Florida. And I'll take it up one higher level and I'll say that I think our fundamental approach to the marketplace is to be very proactive and very disciplined. And sometimes, that creates a first mover disadvantage on us, where we're first to take action, where we see need to do risk mitigation, we're first to take rate where we see emerging environmental and economic trends, and we're first to take proactive action that actually can sometimes impact our growth prospects. So I think you know that we have about 16 states where we're either closed for homeowners' new business or have significant new business restrictions in them. I think Sandy is a good indication of why we did that, and it will prove to have been a good move for us to reduce our exposure in some of these coastal areas. But all of those actions, whether they're profitability actions in New York and Florida on auto or these homeowner actions have an impact on our ability to grow. And as Tom said, you can't take all of these profitability actions. You can't do the non-renewals. You can't do reinspections. You can't tighten underwriting without some impact on our retention, and that is really what we see as our prime opportunity for growth at this point because we think we were early in most of these actions, we were proactive. And as a result, I think we're further along on the timeline, and we are at the point of stabilization, and we are at the point where we are beginning to see pockets of growth. You mentioned broadening the target. We have several growth initiatives out there, including broadening the targets and price optimization work, some additional work to analyze our ability to grow even faster in selected areas. And so, yes, we have those pockets of growth emerging. We have about 20 states right now that had positive year-over-year growth in standard auto. And our hope is over 2013 and 2014, we will dramatically improve that number without losing any of our discipline on the profitability side. So our first mover disadvantage, I think at some point, will work into a first mover advantage, where we will emerge out of this cycle faster than some of our peers and we'll be able to take some of the growth opportunities that are presented to us, which I think are many at this point.

Ian Gutterman
Adage Capital Management, L.P.

Great. So it sounds like you'll be disappointed if we don't see growth in standard auto for 2013?

Matthew E. Winter
President and President of Allstate Insurance Company

I don't remember saying that exactly, but you draw your own conclusion.

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Ian, it's Don. Let me just give a quick update on Esurance. As Tom said, of course, we acquired Esurance so that we could grow in that self-directed segment in a profitable way. That's been the goal; it's to grow our market share profitability. Since the acquisition, we've done a number of things. We've linked the brands together, so it's Esurance and Allstate company, which has played well. We've clarified their position in the market through their features and their technology. We've developed a new ad campaign, and we've thrown a lot of weight behind the new ad campaign intentionally. And here's how I would characterize where we are today. I think we're very happy with the results we're seeing. The response rate with new quotes is up dramatically. The conversion rate is up; the retention rate is up, I mean, you can see it; over 22% improvement in policies since just the beginning of this year. That's a big number. What you're also seeing, though, is a high combined ratio. Part of that is intentional. The advertising model, the accounting model is such that we have to expense that advertising in the quarter we take it, even though the value of the policy continues to linger on through retention. And so, we are watching the GAAP combined ratio. But I'll be honest, we're more interested in the economic combined ratio. If we're convinced that we're writing good business that will be profitable over its life, and we are, then we're comfortable tolerating the GAAP loss ratio being over 100 for some period of time. We also have a little bit of an elevated loss ratio in the third quarter. Gary and his team are watching it closely. We're working together to make sure that we have all our resources between Allstate and Esurance on-the-job. I'm confident that number will get back in line. But all in all, I'll tell you that the growth prospects for Esurance are going up so far very well, and I think we're very optimistic about the future.

Operator

Our next question is from Bob Glasspiegel of Langen McAlenney.

Robert Ray Glasspiegel
Langen McAlenney

I need some little bit of help on your reinsurance slideshow, given that I can't plug this stuff into a spreadsheet. You gave an example of a hurricane going through New Jersey, which seems to have its own cover. And there's 2 different covers, which I don't quite understand how they interact. But I think you talked about a $700 million type loss working its way down to $200 million net, but maybe if you could just give -- if the number was $10 billion in the 3 states, simply what the gross and the net numbers would play out, that would be helpful.

Robert Block

Bob, I can give you a call back later and we can walk through the steps. The 3 contracts -- the contracts in New Jersey all work together. So it's -- I'll give you rough numbers, but it's about $150 million retention, and then, it's 95% reinsured up to the top of the contract. So we can walk you through that.

Thomas J. Wilson
Chairman & CEO

That's New Jersey.

Robert Block

That's New Jersey property losses only. That does not include auto.

Thomas J. Wilson
Chairman & CEO

Right. And then of course -- and as I said, auto flood is covered, and it's at 21 states. So it's a big storm. But we can help you sort out here.

Robert Ray Glasspiegel
Langen McAlenney

So if you had a $10 billion sort of loss in the other 2 states, what would the net number be?

Thomas J. Wilson
Chairman & CEO

First, I assume you're talking about $10 billion as the industry level.

Robert Ray Glasspiegel
Langen McAlenney

Right. Right. Let's say, you had 10% to 12% of that, so $1 billion gross, what would the net be?

Thomas J. Wilson
Chairman & CEO

I think it's highly dependent on the mix of which states and what type of losses. But if you want and you come up with 2 or 3 different scenarios, Bob can show you how those would work through the reinsurance program and you can come up with an estimate on it.

Robert Ray Glasspiegel
Langen McAlenney

Okay. I think others might be interested in this as well. But on Encompass, it looks like a mini-breakout from what's been a troubled line for a long, long time. I mean, you're growing in premiums and the underlying underwriting is improving. Am I overreacting to this quarter or are you -- do you think you got the horse running the right way around the track?

Thomas J. Wilson
Chairman & CEO

Well, I guess -- I would agree. I think, first, this business is a good business for us to be in, serving that customer segment. Second, as you know, that business is probably down $700 million or so in premium over the last 3 or 4 years. And so it's got some room to come back. Some of that, of course, was intentional because we're in places we didn't want to be from a cap management standpoint but there is room to grow that business. Three, we do have new leadership there. Don Bailey has got a new leader in place there. We like the results that he and the team are now driving, so I would hope to be able to see it continue to grow. I'm not sure what breakout is. We all have different assessments of breakout. But I think if you look at what's going on in that customer segment and the companies who serve that segment largely through independent agencies, I think we're well positioned to grow, yes.

Robert Ray Glasspiegel
Langen McAlenney

I was referring to the underlying profitability, underlying combined ratio.

Thomas J. Wilson
Chairman & CEO

Oh, breakout in the profitability. Sorry, I thought you meant breakout and growth. Our profitability has gotten better. I like the trends. I don't -- I'd like to see it -- I'd like to see our combined ratios from down low, but I'd like to see the business grow as well. So I don't think we're going to -- this business, as you know -- we've had that business -- shortly after we bought it we took the combined ratio down from 117 down into the low 90s. I don't expect it to get into the low 90s at this point in this cycle, given where our competitors are. But I think it can be better than it is today, and I think the business can grow at the same time.

Operator

Our next question is from Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Just 2 quick questions here for you. The first one, looking at the slide on the underlying margin trends on the standard auto business, looking at your underlying lost trends and what's going on there. I'm just curious, maybe you can talk about kind of the difference between the paid loss trend in which you're showing here, and the incurred loss trend. Because the paid loss trend appears like in the last couple of quarters has been above where your average earned premium per policy has been.

Matthew E. Winter
President and President of Allstate Insurance Company

Yes. Brian, it's Matt. So you have all the issues that come up with paid loss trend, and I guess, BI paid severity is a good example of that. So you look at BI paid severity and it looks fairly dramatic. But as Bob said in his opening comments, about 1/2 of that increase can be accounted for as a change in the mix of claims settled by report year and a shift in the state mix, and the other 1/2 is consistent with the medical CPI. So we do have, I guess, some distortion that's always present when you look at the paid versus incurred. But I think if you look -- and I'm assuming you're referring to the bottom chart on Page 7 of the presentation, the underlying margin trend. I think if you look at that consistent pattern over the last several quarters with the nice trend line between earned premium and the losses, I think our goal is to manage that and our goal is to look at the loss trends in aggregate. I think it's somewhat dangerous to focus on the attribution analysis of each component. We have a term Tom and I throw around a lot here. It's "false precision." And we can get trapped in our own map, and we look at it -- we do the attribution analysis and we try to understand each of the drivers, whether they're medical inflation or whether they're a report year or a shift in state mix. But then we look at the aggregate loss trends and the aggregate premium trends, and we look at our rates that we're taking. And our attempt is to manage some of those levers so that each of those -- on one quarter, one is going to go up, the other is going to go down. It's like pushing on a balloon. And our job is to manage the overall size of the balloon and how much air is in there and the pressure being exerted on it. And I think history will show that our team is exceptionally good at managing that. They manage each of the components. They manage loss trends very carefully while maintaining a good customer experience and good customer treatment. And they're very proactive in looking at emerging economic and environmental trends and taking rate where it's appropriate and warranted and mandated and justified. And so I won't get too caught up in the paid volatility. I get a little more focused on the underlying trends, and that's why we tried to show them to you in the slide presentation.

Robert Block

Brian, it's Bob. Just a couple of things to keep in mind. Remember while you're looking at the paid severity trends, you also have to look at the frequency trends. Frequencies are down. And the fact that bodily injury and property damage together make up about 45% of the standard auto losses. So there are other coverages that are in there -- collision comp, uninsured motorist, and everything -- where the trends are good as well. So you're looking at 2 of the big covers, but there are still other pieces to that puzzle, and also the fact that I think you can tell from our reporting on reserves. Our reserves are reasonable and they're accurate.

Brian Robert Meredith
UBS Investment Bank, Research Division

Yes, you bet. Absolutely. And just one quick one on the life insurance business, if possible. Your investment spreads really kind of improved this quarter. I wonder if there's anything unusual going on there.

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Our investment spreads, Brian, did get a lot better. I think you see several things going on. Some of it is what you'd expect, so we continue to work on crediting rates, and that's being offset somewhat but the lower yields in the portfolio and the continuing lower asset levels. But the investments spread, the biggest impact is the option valuation from the equity index annuities. I think if you look at apples to apples, you're going to have to take that out, and then you get back to what I said, which is the crediting rates offset by yields and the asset levels.

Operator

Our next question is from Michael Zaremski of Crédit Suisse.

Michael Zaremski
Crédit Suisse AG, Research Division

In regards to Hurricane Sandy, it looks like insurance regulators in at least a few impacted states are saying the storm won't technically be classified as a hurricane; therefore, our hurricane deductibles won't apply. So I was curious how the difference between a hurricane versus a tropical storm classification impact Allstate.

Thomas J. Wilson
Chairman & CEO

First, if you're interested in the science of it, a hurricane is -- it gets its energy from the water. The winter storm, or Northeaster, gets its energy from the temperature differential in the air. And so that's why it's been classified that way. The tropical cyclone deductible, it probably will not be triggered up in the Northeast, and we're prepared for that, and that's what's fair and accurate for our customers. It may or may not -- I'm not sure where we are down in the far Southern states. There maybe a few states that would -- but the damage is much less severe down there than where the hurricane turned in.

Michael Zaremski
Crédit Suisse AG, Research Division

So would you say the kind of estimates that a lot of the reputable firms are putting out there take into consideration that those -- the higher deductibles won't be triggered?

Thomas J. Wilson
Chairman & CEO

I don't know for that. I don't know, Mike. Not everybody has a tropical cyclone deductible. I don't know how good their models are on that. It's, of course, very complicated because even when you have it in the marketplace, not every policy has it on it. And so I would say, to the extent it is not triggered, industry losses would obviously be higher than when it is triggered because that's a higher deductible than you would have on a normal all peril policy. But I don't think it would substantially alter the numbers, which are such big wide slots anyway. Now you know that the ranges are billions of dollars, so I don't think it would impact it much.

Michael Zaremski
Crédit Suisse AG, Research Division

Okay. And as -- in regards to, Tom, the 13% ROE target on a normalized catastrophe load basis obviously. So where will most of the increase come from now given that you guys seem to be getting close to the goal within homeowners not looking to increase auto profitability? I guess I do recall at the Investor Day you talked about unlocking capital within the life insurance segment. Maybe you can update us on that.

Thomas J. Wilson
Chairman & CEO

Okay. First, my entire team is raising their hands saying they're going to deliver it. They each want to [indiscernible] First, I think -- I would say we're above that target for the last 12 months, and I think that is reflective of where we would hope it would come from which is maintaining auto margins, improving returns in the homeowner business and getting returns up in the life business. But of course, there were 2 things that happened this quarter, which we wouldn't expect to happen every quarter. One is low path [ph] and the other is the change in the investment spreads that we just talked about. So we still have work to do to fill up the profits ahead of that. So homeowners is -- we feel very good about where it's at. Matt and his team are working hard on it. We've been at this for a while, as you know. We're definitely at a much better position. And we're doing a good job on auto profitability. We do have a little bit of a headwind in the life business with low interest rates, which starts to drift over into the property casualty business. We're going to work to manage our way through that and still achieve our goal, but there's a little bit of a headwind there. To the extent we can reduce the size of the annuity business faster, we will seek to try to do that. It was down about almost $4 billion over the last year. I think it's like $3.8 billion. But it was only down about $700 million in the last quarter. So you can see that rate of decline is down a little bit, and because of low interest rates and people don't want to surrender their policies. So Don and his team are hard at work trying to figure out other ways we can reduce the size of the annuity business, not the life business. The life business is getting good returns for us, the Life Insurance business. So to the extent we can reduce that business, that, of course, frees up capital and we get a higher return out of that as well. So we have a little more work to do on all fronts, but we're feeling better about where we're at.

Michael Zaremski
Crédit Suisse AG, Research Division

Sorry. I guess just as a final follow-up then, so within the Allstate Financial, should we be looking at the statutory capital? Because that amount of capital has kind of been staying the same over the last year. The annuity portfolio has been running off, attrition in life has been growing. So we should we expect -- should that number be expected to drift downwards if the current run rates continue?

Thomas J. Wilson
Chairman & CEO

I would -- as the size of -- as Steve pointed out, the size of that portfolio is down about $20 billion or so in the last 3 or 4 years. As that size of that portfolio comes down, I would hope we could have dividends out of that business which would be the statutory capital, yes.

Operator

Our next question is from Matthew Heimermann of JPMorgan.

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

A couple of questions. One, just on homeowners, I was just trying to get a better sense of what the underlying improvement was. On my math, kind of adjusting for the non-cat weather that you've benefited -- you've quantified in previous quarters. It looks like year-to-date, we've got about 470 basis points of improvement, which is a little faster than I think the run rate you all have talked about in the past, and I'm just curious if you could remind us -- I think the difference is there was some adverse weather in 2011. So just remind me if I'm thinking about kind of the puts and takes right.

Matthew E. Winter
President and President of Allstate Insurance Company

Matt, it's Matt. I'm trying to understand your question a little bit. Are you asking about what component is sustainable and what is -- what component is based upon the lower-than-normal cat?

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

Well, you've quantified the lower-than-normal cat, so if I look at just loss ratio, I'm getting year-to-date improvement, 9 months over 9 months of about 470 basis points. And I think, historically, when you've talked about -- so that seems high to me relative to what you've talked about kind of your expectations of core margin improvement. So one, I guess comment on whether or not that perception is correct, about how 470 might compare to your run rate expectation. And then secondly, if it is in fact, a little bit faster, is that attributable to the fact about 2011, I think in 1Q in particular, had some unfavorable weather that might be making that look little bit better. I'm just asking because I want to make sure that as I think about next year, I'm not botching anything up.

Matthew E. Winter
President and President of Allstate Insurance Company

Well, that is true. So we had some unfavorable weather that exacerbates the year-over-year view. But also, I think the other way of looking at this is that this is a fairly volatile business and trying to do it over year-over-year while we're declining, and if in selected areas on the coast, is a little distorted because we're changing the mix of the housing, we're changing the risk profile of the homeowners business as an overall block. And so trying to compare year-over-year as if it's a stagnant steady mix is a little distorted. I think we're changing the risk profile of the business a little. House & Home, as you know, it's gone in. It was 12 states in the third quarter, as I think Tom mentioned, another 5 in October, so 17 states. That has a different risk profile. And we underwrite roofs differently. We assess the risks differently using some tools that we're used to using on the auto business. And so while -- we are seeing normal year-over-year improvements, where you could back out some of the things, we're also seeing a changing homeowners business, which I think is going to continue to improve. And so I would say that the quality of what is there is higher than it was even a year ago. And I think a lot of what you're seeing that you can't get to mathematically is a result of that change in quality of the business.

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

Okay. And then as we play that forward in the next year, do you feel like -- is that something that we should expect to continue to help a little bit on the margin as we go into next year, or now we kind of -- is the impact going to be a less dramatic?

Matthew E. Winter
President and President of Allstate Insurance Company

Well, it will be less dramatic. As we put in House & Home, we try to put it in the highest leverage areas first. And so we clearly wanted to maximize the early impact of the shift. And a lot of our efforts on nonrenewal and reduction of homeowners in the coastal areas and high-risk areas is well into the latter part of the timeline. So I would not straight-line it. I think you'll see a continued improvement as a result of those 2 efforts, but not at the same pace as we've currently experienced it.

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

Okay. That's helpful. Sorry that it took so long for me to ask the question in a way that made sense.

Matthew E. Winter
President and President of Allstate Insurance Company

No, no, no. I'm sorry I was struggling with where you were going with it, so I wanted to make sure I was answering what you were truly asking.

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

Yes, and that was helpful. Then I guess just one on Sandy. And this just goes to -- one of the -- I'm going to bring up Katrina not because I think that should be the baseline when we think about the loss but because there were a lot of adjusting issues because surge is really a big potential loss driver here. Whether it's insured or uninsured or government insured is a different question. But Katrina, right, there were some regulatory push to cover flood losses. But wind -- and there was a lot of gray as to what caught -- and in some cases because there was a lot of gray and there weren't houses left to actually adjust. I'm curious when you think about Sandy based on -- and I know it's early, but do you think -- how is the gray area in this loss wind versus flood on the personal line side contrast with kind of your experience with Katrina? Is that something that gives you a lot of pause, recognizing that normally when you get big events, the tides usually go to policy holders. But I'm just curious more whether or not there will be as much gray.

Thomas J. Wilson
Chairman & CEO

Let me give you a quick answer because I want to make sure we get a couple of other questions in here. Of course, it's too hard to tell, I haven't been on the ground out there so it's hard for me to see. I will tell you that as it relates to Katrina, we did very well on wind versus flood. We were proactive about our approach to that. And of course, the issue there was a house on the coast, big hurricane comes, house is gone. Was it the wave and then the wind came? Or was it the wind and then the wave came? And trying to sort that out. That doesn't appear to be the situation here, but it's way too early to tell what the issues will be. I will tell you that we have a history, though, of doing what's right for our customers and giving them what they paid for.

Operator

Our next question is from Adam Klauber of William Blair.

Adam Klauber
William Blair & Company L.L.C., Research Division

How aggressively do you plan on rolling out Drive Wise next year? And is your intent to use that to augment growth, augment profitability or both?

Thomas J. Wilson
Chairman & CEO

Well, we don't disclose which states we're going to do it in, Adam. But I will tell you, we like what we see. The customer uptake is a little higher than we thought it would be initially. We think we have a slightly different offering than other people because the device stays in the car as opposed to coming out of the car, which gives us the ability to have a different customer relationship, which says that it should work on both of the elements you've talked about.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay. And one follow-up question. It appears that you make more money this year than you have in probably 4 or 5 years. How is that going to reflect when you think about the buyback for next year?

Thomas J. Wilson
Chairman & CEO

Well, obviously, I can't comment of what we'll make this year because we're still trying to sort out with Sandy. But I'd like that to be the case, obviously. And let me maybe just go up to capital. We are obviously well capitalized. Today, we have plenty of capital, any which measure you want to put it at. We also generate substantial capital. And we have access to capital in the marketplace. So we have 3 sources of funds from which we could buy back shares or use our capital to grow the business. Obviously, our preferred option is to grow the business particularly in the auto business where we're getting very high returns. Occasionally, we make what I would call, modest acquisitions, whether it be Esurance or Encompass or the Benefits business we bought. And we've gotten good returns on those, but those tended not -- they tend not to be a big portion of our utilization of capital. Of course, as you know, about 80% of the capital we returned to shareholders through dividends or share repurchases. And that has been our history for a long time. When you look at dividends, we, of course, make the decision -- the board makes the decision every quarter. Right now, when you look at our dividend rates, whether that be payout or yield, they look a little low relative to where our stock price is and earnings are. So we'll consider that in the beginning of the year as to what we should do with the dividend. And then on share repurchases, we're not obviously done with the current program. When we are, we'll look at all the sources of capital we have, either the capital on our balance sheet today, our capital generation potential or ability to access capital because as you know, there are some pretty attractive markets today with our equity life securities to use that to restructure and lower our cost of capital. So that's the way we think about it. When we get done with this, which we're pretty close now, we'll be thinking our way through them.

Operator

Our next question is from Michael Nannizzi of Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Most of my questions have been answered. One question I just have, when you look at insured losses that will come out of Sandy, do you -- how much of that end up getting absorbed or do you think will end up getting absorbed by the National Flood Insurance Program?

Thomas J. Wilson
Chairman & CEO

Really hard to tell, Mike. We don't really -- it's almost impossible to tell right now. I would tell you but you want to go way up. The National Flood Insurance Program ends up being a net drain on the U.S. government. It really is -- if it was your business, you would seek to restructure that business charge of the accurate prices relative to where people's houses were. You'd try to expand the coverages so you weren't only ensuring those houses that get flooded 2 and 3 times. So there is -- I think -- and Congress has struggled with that over time, but their losses are -- the net losses will probably end up being bigger than they would need to be if you brand it as a private business rather than as a political entity. I can't give any estimates for the exact number. I have no idea.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And then just maybe one on Allstate Financial. I mean, it seems like, I mean, you're clearly moving towards a more underwritten profile as opposed to a spread business. I mean, what is your kind of expectation for that business longer-term? I mean, it doesn't seem like other than the life products, now it doesn't seems like there's a lot of operational synergy or overlap with your kind of captive agent platform. I'm just trying to understand kind of where do you see that business moving as you execute your transitional strategy there?

Thomas J. Wilson
Chairman & CEO

Okay. Well, we look at it a couple of ways, Mike. First, we look at it strategically as it relates to our customers, and then we'd look at it to say where do we get a decent returns. So strategically as it relates to those personal touch point [ph] down in the lower left-hand corner, want advice and a relationship and want branded products. They want to buy all things -- more things from one person rather than multiple people because they don't just feel like having 15 different relationships. Life insurance, some retirement products obviously fit into that category, and we do well there. The life sales, I think are up 6% or 7% this year so far. And we like what we have there in terms of bundling that together. That's good for the customers. That said, it doesn't mean we need to make everything we sell. So we sold the VA business in 2006. Our fixed annuity business today, we use a lot of outsourced products. We have some proprietary products still in that channel, but we use outsourced products. We could -- on the Annuity business, if you don't like the return, now we'll just sell an outsourced product with someone who has a different return objective on it. On the Life Insurance business itself, just life insurance policies, we're getting pretty good returns on our capital well above our cost of capital there. And so we've done that. But we try to separate it into 2 things: what do we need to do for our customers, and then what do we need to do for our shareholders. And we manage our way through that. And that's why we're taking the size of that annuity business down is we don't need to have shareholder capital employed in that to execute our strategy.

Operator

And our final question today is from Randy Binner of FBR.

Randolph Binner
FBR Capital Markets & Co., Research Division

This is another Allstate Financial question. But I appreciate all the commentary on trying to kind of redeploy capital out of particularly the annuity business into what you've perceived to be higher kind of better risk-adjusted returns in really the other protection businesses. And so, I guess just as I think about modeling to the extent that you're successful in kind of getting folks to give up those annuities and then you're able to free up capital from the annuity business, that takes time, and then reallocate it, I'm just trying to think if there is going to be kind of a donut hole or a lag in the earnings that you generate as you kind of transfer that capital around. And so, you know, I guess I'd be kind of interested in your thoughts on that approach, kind of how that affects 2013 earnings. And then I'm not sure if I've heard this in the commentary, but are you thinking about kind of more aggressively trying to go after annuity holders and maybe giving them lump sum payouts or other incentives to surrender?

Thomas J. Wilson
Chairman & CEO

On the last part of your question, the answer would be yes, we are actively looking at that. On the 2013 earnings capital generated from accomplishing that, I would say it's not likely to have a meaningful impact on overall earnings. So if it -- if you just -- you could do the math. For every $100 million of earnings of Allstate Financial, even if you redeploy it into some of that business, we could redeploy it get a higher return than what's it's getting today, even in investing. But it would not be meaningful to force.

Randolph Binner
FBR Capital Markets & Co., Research Division

So I guess it happens gradually enough over time that there isn't a big block of capital that go -- it needs to get upstream then reallocated and then earned against. It's more of a gradual process because -- I guess in our model, it seems like as you move capital out, there's a little bit of a lag, but it sounds like it's more of a gradual process from your perspective.

Thomas J. Wilson
Chairman & CEO

I would say -- yes, I'm sure there's a lag, but it's not in terms of the overall scope and projections of the company. If you would change auto frequency by 0.5 point, it would have a bigger impact than this would. So you're right. But I would just say as it relates to Allstate Financial, we're approaching it as a "do it smart, do it when you can." And so don't look for sort of a simple, easy solution, where it all goes -- you just change it all. And it's got a kind of do it by line. So Don got the annuity business broken into a whole bunch of different segments, some he cares more about than others. And those that are the biggest in the hole he's working harder on and those that are earning a positive or above cost of capital return. So it's highly segmented, this strategy.

Let me close and just say, first, thank you. We had a good quarter. We're on track for all of our core priorities. If those of you who are still on the queue, Bob is available today, working all day. So feel free to reach out or he'll reach out to you. And as it relates to Sandy, we're working hard to do what our customers pay us for. We'll provide additional perspective on loss estimates when we can give you a more informed perspective. So thank you very much, and we'll talk to you next quarter.

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