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S&P Capital IQ

The Allstate Corporation NYSE:ALL

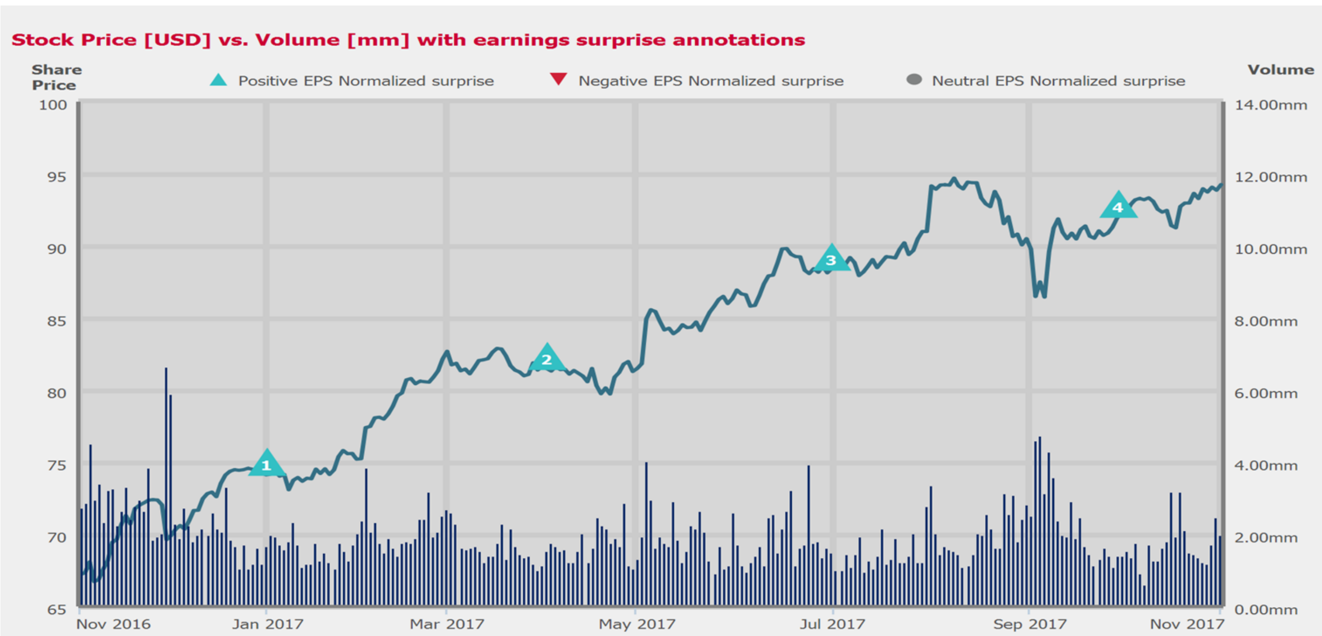
FQ4 2017 Earnings Call Transcripts

Thursday, February 08, 2018 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2017-			-FQ1 2018-	-FY 2017-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.53	2.09	▲36.60	2.44	6.13	6.71
Revenue (mm)	8091.20	8202.00	▲1.37	8112.00	32174.50	32300.00

Currency: USD
Consensus as of Feb-08-2018 10:34 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2016	1.61	2.17	▲34.78 %
FQ1 2017	1.10	1.64	▲49.09 %
FQ2 2017	0.90	1.38	▲53.33 %
FQ3 2017	0.83	1.60	▲92.77 %

Call Participants

EXECUTIVES

Glenn T. Shapiro
President of Allstate personal lines

John Griek
Head of Investor Relations

Mario Rizzo
Executive VP & CFO

Matthew E. Winter
President and President of Allstate Insurance Company

Thomas Joseph Wilson
Chairman & CEO

ANALYSTS

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Jay H. Gelb
Barclays PLC, Research Division

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Sarah Elizabeth DeWitt
JP Morgan Chase & Co, Research Division

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Allstate Fourth Quarter 2017 Earnings Conference Call. As a reminder, today's program is being recorded.

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

John Griek
Head of Investor Relations

Well, thank you, Jonathan. Good morning, and welcome, everyone, to Allstate's Fourth Quarter 2017 Earnings Conference Call. After prepared remarks by our Chairman and CEO, Tom Wilson; Chief Financial Officer, Mario Rizzo; and me, we will have a question-and-answer session.

Yesterday, following the close of the market, we issued our news release, investor supplement and posted the results presentation we will use this morning in conjunction with our prepared remarks. These documents are available on our website at allstateinvestors.com.

As noted on the first slide, our discussion today will contain forward-looking statements about Allstate's operations. Allstate's results may differ materially from these statements, so please refer to our 10-K for 2016, the slides and our most recent news release for information on potential risks. This discussion will contain some non-GAAP measures for which there are reconciliations in our news release or our investor supplement.

In the fourth quarter, the company adopted new reporting segments, expanding from 4 to 7. The new structure provides enhanced transparency and allows for an evaluation of our businesses grouped by like attributes.

Also, in the fourth quarter, we discontinued the use of the term, operating income, and have replaced the label with adjusted net income. We are recording this call, and a replay will be available following its conclusion. And as always, I will be available to answer any follow-up questions you may have after the call.

And now, I'll turn it over to Tom.

Thomas Joseph Wilson
Chairman & CEO

Well, good morning. Thank you for joining us to stay current on Allstate's operating results. At the beginning of the year, we made several leadership changes in anticipation of Matt Winter's retirement later this month. Matt has been instrumental in our proactive operating approach and helped maintain our deep bench talent. Matt and the rest of the senior leadership team are here with us today, which includes Glenn Shapiro, who's assumed leadership of the Allstate brand, Property-Liability business.

Glenn joined us about 2 years ago, has 28 years of insurance experience. He successfully led our claims operation as part of Matt's team, and they did a number of very innovative things like improving our processes to control costs and introduced new technologies, such as QuickFoto Claim app.

Steve Shebik is our Vice Chair, and he's taken on responsibility for Esurance, Encompass, Allstate Life, Annuities and Benefits, Business Transformation and D3, our analytics operation. You all know Steve. He's been with us for 23 years and most recently with our Chief Financial Officer. Mario Rizzo is now our Chief Financial Officer replacing Steve. So you're going to see a lot of him. He most recently was the CFO of Allstate Protection, and he's been with us for 28 years.

Also here with us today are Don Civgin, who's President of Allstate Service Businesses; John Dugenske, who's our Chief Investment and Corporate Strategy Officer; Mary Jane Fortin, who leads our 3 Allstate

Financial businesses, the Life, Retirement and Benefit businesses; Eric Ferren, our Controller and Chief Accounting Officer.

So let's start on Slide 2. We delivered strong results in 2017 and are positioned for profitable growth. Net income for the fourth quarter of 2017 was $1.2 billion or $3.35 per share, but that did include a onetime $506 million increase to net income as a result of the recently passed tax legislation.

Adjusted net income per share was $762 million or $2.09 a share, and that excludes the impact of the tax change and $125 million goodwill impairment in Allstate Annuities, which related to the change in reportable segments.

For the full year, adjusted net income of $2.5 billion was 34% above the prior year and reflect strong performance from our market-facing businesses and investments. The Allstate auto and homeowners insurance margins remained very strong, and performance-based investments had outstanding results.

Catastrophe losses of $3.2 billion were 26% above the prior year, but were largely offset by favorable prior year reserve reestimates. Adjusted net income return on equity was 13.3%, as you can see on the bottom right. This operational success will support accelerated growth in 2018, while maintaining attractive returns.

So let's go to Slide 3. Now this addresses the impacts of the Tax Cuts and Jobs Act of 2017. So the immediate impact from tax reform is that onetime $506 million increase to net income, which is driven by a reduction in our net deferred tax liability. This principally relates to deferred acquisition costs, which were already expensed for tax purposes at a higher tax rate. It also reflects lower future taxes on unrealized investment gains.

In 2018, we anticipate a corporate tax rate of 19% to 20% compared to our historical effective tax rate in the low 30s.

Future auto and homeowners insurance rate filings will reflect the impact of lower tax rates and will be factored into our regulatory filings, but we do not expect this to have a material impact in Allstate's near-term operating results or competitive position. We are taking advantage of lower taxes to increase growth, enhance the employee value proposition, raise shareholder returns and improve our local communities. We're investing in growth in many of our market-facing businesses through marketing, distribution, telematics, new products and technology.

Employees will receive [$1,000 or $2,000] choice dollars in 2018 depending on their participation in our medical benefit plan. This money can be contributed to a 401(k) or a health savings account or taken as a cash bonus. This structure of employee choice will be incorporated in the future benefits design.

We'll also increase employee training and technology literacy to support sustainable employability. This is increasing in importance, particularly in our business, as jobs are reconfigured and eliminated by digital technologies and the increased use of computer decision-making using advanced analytics. Reflecting strong operating results and lower tax in the first quarter dividend was increased by 24%, which is up to $0.46 per common share.

We also contributed an additional $34 million to the Allstate Foundation in December to expand existing programs. And Allstate Agency supports the local process, and you can see this had an impact on fourth quarter expense levels.

Turning to Slide 4. We had good results on all 5 2017 operating priorities. We better served customers. And the Net Promoter Score, which measures how likely customers are to recommend us, increased. Customer retention for Allstate brand's auto improved in the second half of 2017, and Esurance auto and homeowners insurance retention increased throughout the year, which have maintained increased growth in 2018.

Higher customer satisfaction in part reflects fewer price increases, but we also improved service in a number of areas, such as expanding the utilization of QuickFoto Claim, which can lower settlement times from days to hours, as you've probably seen in our advertising.

We continue to deliver excellent returns on shareholder capital. The Property-Liability reported combined ratio of 93.6, generated $2 billion in underwriting income for the year (sic) [p.4, "profit of $725 million despite $2.1 billion of catastrophe losses"]. Auto insurance underwriting income increased due to lower accident frequency, higher premiums and favorable prior year reserve reestimates.

Allstate brand homeowners insurance posted a combined ratio of 89.4 despite significant catastrophe losses, making this the sixth consecutive year of the combined ratio that's been below 100.

Allstate Life and Benefits generated attractive returns. And annuity income was up, but returns are still low. Total policies in force grew to 82.3 million in 2017. Property-Liability policies in force declined due to the impact of the profit improvement actions begun in 2015.

SquareTrade policies grew 10 million or nearly 36% in 2017. Allstate Benefits continued its 17-year track record of growth, with policies in force increasing by 7.4% in 2017. Total return on the $83 billion investment portfolio was 5.9%, reflecting strong results in both the market and performance-based portfolios.

We also built long-term growth platforms. SquareTrade's first year performance was very strong on the 3 factors for success we laid out when the acquisition was closed in January. We already signed its first third-party insurance customer to expand its platform outside the Allstate entities. If you look forward to 2018, go to Slide 5, we are well positioned to accelerate profitable growth. The Property-Liability business is expected to have an annual underlying combined ratio between 86 and 88 in 2018. This range considers the impact of growth and the effect of the lower tax rate that we just discussed.

Our priorities for 2018 are consistent with 2017. So the first 3, better serve our customers, achieve target economic returns on capital and grow the customer base, those are obviously all intertwined, and ensure the corporation has multiple paths to profitable long-term growth.

In 2018, Allstate brands, Property-Liability, Allstate Benefits, SquareTrade and Esurance, are all expected to contribute to growth. Mario will now go through our Property-Liability results.

Mario Rizzo
Executive VP & CFO

Thanks, Tom. Slide 6 shows Property-Liability results by customer segment and brand. Starting with the table at the top, net written premium was $7.8 billion, a 3.6% increase from the prior year quarter. The recorded combined ratio of 91 was 1.3 points higher than the fourth quarter of 2016. Included in these results were higher catastrophe losses, increased agency and employee compensation costs as well as an increased donation to the Allstate Foundation.

This was partially offset by increased premiums earned, lower underlying loss costs and higher favorable prior year reserve re-estimates. When we exclude catastrophes and prior year reserve reestimates, the underlying combined ratio was 85.7 for the fourth quarter of 2017 and 84.9 for the full year. The full year underlying combined ratio, as historically reported, including the Property-Liability and service businesses, was 85.6, which was below our annual outlook range of 87 to 89.

As you know, our strategy is to provide differentiated customer value propositions for the 4 consumer segments of the Property-Liability market. The Allstate brand in the lower left competes in the local advice and branded segment. Net written premium was 4.1% higher in the fourth quarter of 2017 compared to the prior year quarter, primarily due to a 4.2% increase in auto insurance premiums. The underlying combined ratio was 84.8, with the favorable prior year comparison driven by improved loss trends in auto insurance, which had a 94.2 underlying combined ratio, 2 points below the prior year quarter. Esurance, in the lower right, serves customers who prefer a branded product, but are comfortable handling their own insurance fees. The underlying combined ratio for auto insurance continues to improve relative to prior year, and was 101 in the fourth quarter of 2017.

Esurance net written premium grew by 2.8% compared to the prior year quarter. Our strategy to broaden customer relationships is successful, as homeowners insurance policies increased 36.2% in 2017, with written premium increasing 26.7% in the fourth quarter of 2017 compared to the prior year quarter. The underlying combined ratio of 99.8 was 5.2 points better than the prior year quarter with improvements in both auto and homeowners insurance.

Encompass, in the upper left, competes for customers who want local advice and are less concerned about the brand of insurance they purchase. We continue to make progress in improving underlying margins. Let's go to Slide 7 to cover the results for Allstate brand auto insurance. Starting with the top-left graph, the recorded combined ratio for the full year was 93.2, generating $1.3 billion in underwriting income in 2017. These results reflect increased average earned premium, lower frequency and favorable prior year reserve reestimates primarily related to injury coverages.

The underlying combined ratio of 94.2 in the fourth quarter of 2017 improved by 2 points compared to the fourth quarter of 2016, driven by a 3.7-point improvement in the underlying loss ratio. The expense ratio was 26.2, 1.7 points above the prior year quarter.

The chart on the top right shows the results of the broad-based profit improvement plan initiated in the second half of 2015. Annualized average premium, shown by the blue line, increased by 4.5% to $1,022; while underlying loss and expense, shown by the red line, increased 2.3%. This resulted in a favorable GAAP of $59 per policy compared to the low 20s experienced in the fourth quarter of 2015.

Gross frequency trends for bodily injury and property damage coverages are shown on the bottom chart. In the fourth quarter, frequency continued to perform below the elevated levels experienced in 2015 and 2016, and favorable trends remained geographically widespread.

Slide 8 shows the underlying drivers of policies in force for Allstate branded auto insurance. Starting with the graph at the top, overall policies in force grew sequentially in the fourth quarter of 2017. The bottom 2 charts highlight both the renewal ratio and new issued applications for Allstate branded auto insurance. The renewal ratio is a bigger influence on total policies in force, and we continue to focus on improving the customer experience.

The renewal ratio of 87.8 was an improvement of 0.4 points from the prior year quarter.

New issued applications grew year-over-year for the fourth consecutive quarter, increasing 10.3% compared to the fourth quarter of 2016. Executing our trusted adviser strategy, along with expanding distribution capacity and efficiency, will help build growth momentum throughout 2018.

Slide 9 shows similar information for Allstate brand homeowners. The top part of the page provides detail on our profitability results. The homeowners recorded combined ratio was 85.4 in the fourth quarter, which generated $252 million in underwriting income, as Allstate's effective risk and return management strategy drove strong performance despite significant California wildfire losses.

For the full year, despite $2.1 billion in catastrophe losses, the reported combined ratio was 89.4; while underwriting income was $725 million for the year, which was a $373 million decrease relative to the prior year. The bottom half of the page provides detail on policies in force, which declined 0.5% in 2017, but grew sequentially compared to the third quarter of 2017. The renewal ratio of 87.5 was unchanged compared to the prior year quarter. New issued applications growth accelerated to 6% in the fourth quarter of 2017.

As auto insurance retention and new business levels have improved, we are seeing a favorable impact on homeowners policies in force.

Slide 10 provides additional financial highlights for Esurance. Esurance made progress on improving financial results and positioning the business to resume growth in total policies in force. The recorded combined ratio of 100.2 in the fourth quarter, shown on the left chart, was 4.8 points below the prior year quarter, primarily driven by a lower expense ratio. The auto underlying combined ratio for the full year was 100.2, 5 points below 2016 due to lower expenses.

Esurance growth trends are highlighted on the right-hand chart. Net written premiums continue to grow on increased average premium, while policies in force declined compared to the fourth quarter of 2016. Policy growth in homeowners partially offset the decline in auto policies due to profit improvement actions.

Slide 11 provides additional highlights for Encompass. Encompass continues to improve underlying profitability, while executing growth plans and states with rate adequacy and long-term growth potential. Encompass reported combined ratio was 106.4 in the fourth quarter of 2017, and was impacted by significant catastrophe losses, primarily due to the California wildfires. The underlying combined ratio of 86.4 for the fourth quarter was 4.3 points lower than the prior year period due to improvement in the underlying loss ratio, partially offset by a higher expense ratio.

Shown on the right chart, Encompass net written premium declined 7.6%, and policies in force were 14.4% lower in 2017. The decline in premium and policies in force in states with inadequate returns has impacted overall top line trends. Now I'll turn it over to John.

John Griek
Head of Investor Relations

Thanks, Mario. Let's go to Slide 12, which provides detail on service businesses, a new reportable segment which offer a broad range of products and services that support our customers and enhance our customer value propositions.

Our strategy to deliver superior value propositions and build strategic platforms made good progress in the fourth quarter, as policies in force grew to $43.5 million and revenue growth accelerated to $264 million for the quarter. Net income of $95 million in the fourth quarter 2017 included a $134 million benefit from tax reform, while the adjusted net loss was $24 million in the quarter. In its first year under Allstate ownership, SquareTrade had very strong performance and achieved the 3 factors for success we identified when the acquisition closed in January.

Policies in force grew to [38.7 million] in the fourth quarter of 2017, an increase of 4.6 million policies compared to the third quarter. We executed a 100% quota share agreement this year with our largest third-party reinsurer, which further enhanced the economics of the business. We also continue to invest in accelerating growth, both domestically and internationally.

In the fourth quarter, Arity established relationships with insurance and shared mobility companies, expanding its platform outside of Allstate entities. Allstate Roadside Services revenue declined in 2017, reflecting nonrenewal of unprofitable third-party contracts. And adjusted net loss was realized in the fourth quarter and for the year as the new digital platform, which reduces response time, is not yet profitable.

Turning to Slide 13. Let's review our Allstate Financial -- Allstate Life, Benefits and Annuities results. As a reminder, these are 3 new segments, which were historically consolidated into our former Allstate Financial segment.

Allstate Life adjusted net income, shown on the top left chart, was $57 million in the fourth quarter, a $9 million decrease compared to the prior year quarter. This is primarily due to increased contract benefits and operating expenses, partially offset by higher premiums.

Premium and contract charges, shown on the bottom left, increased 1.9% in the fourth quarter of 2017. Allstate Benefits adjusted net income, shown in the top middle chart on the page, was $20 million, a $3 million decrease compared to the prior year quarter. The decrease was primarily due to higher contract benefits and operating expenses, partially offset by higher premiums. Allstate Benefits continued its strong track record of year-over-year top line growth. Premiums and contract charges, shown on the bottom middle chart, increased 8.3% in the fourth quarter, with 7.4% growth in policies in force in 2017. Allstate Annuities adjusted net income of $55 million in the quarter was an increase of $14 million compared to the prior year quarter, reflecting higher investment income on continued strong results in our performance-based investment portfolio.

Slide 14 highlights our investment results. The markets performed well in 2017, driving positive returns across essentially all asset classes, and our portfolio clearly benefited. While we participated in the market momentum, our investment strategies and risk positioning, including the shift to performance-based investments, contributed to our strong results. The components of net investment income are shown in the left chart. Net investment income for the fourth quarter was $913 million, 14.4% or $112 million higher than the fourth quarter of 2016. Market-based investment income, shown in the blue, was stable.

Performance-based investment income, shown in the gray, was the primary driver of the increase over 2016, generating $296 million of income in the fourth quarter. Our performance-based investments benefited from higher balances and favorable market conditions, in addition to our performance by select investments and sales into strong markets. The components of annual total return on our diversified [$83 billion] portfolio are shown in the table on the right. The annual net investment income contribution to returns has been fairly consistent, while realized capital gains and losses and changes in portfolio valuations vary with market conditions, and can be either positive or negative.

The contribution to total returns from the income statement and portfolio valuation are shown in the bottom rows of the table.

As we mentioned last quarter, beginning in 2018, changes in the fair value of our public equity securities will be reported as realized capital gains and losses and included in net income rather than a component of equity in accumulated other comprehensive income.

The book value of the portfolio already reflects changes in fair value. However, this accounting change will increase the variability of reported net income, but the long-term economic value creation would be unchanged. Changes in the fair value of our fixed income securities will continue to be reported as unrealized gains or losses as a component of accumulated other comprehensive income.

Slide 15 provides an overview of our capital strength and financial flexibility. As you can see from the box at the top, we have delivered excellent returns, increased book value and maintained a conservative financial position, while increasing shareholders' ownership in the company by reducing the number of outstanding shares.

Adjusted net income return on equity was 13.3% for the 12 months ended December 31, 2017, an increase of 2.9 points compared to the prior year period, and book value per common share of $57.58 increased 13.4%. We returned $1.9 billion to common shareholders in 2017. This includes repurchasing 15.8 million shares of our common stock or 4.3% of those outstanding at the beginning of the year. As part of our current share repurchase program, on December 8, 2017, we entered into an accelerated share repurchase agreement to purchase $300 million of our outstanding shares of common stock. This agreement was completed on January 5, 2018, and we repurchased a total of [2.9 million shares]. Additionally, we paid $525 million in common shareholder dividends during 2017. The Board of Directors also approved an increase in the quarterly dividend per common share to $0.46 from $0.37, representing a 24% increase payable in cash on April 2. And now, I'll ask Jonathan to 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 PLC, Research Division

First, on the outlook for the underlying combined ratio in 2018 of 86% to 88%, clearly, a little higher than the 85.6% in 2017. If I look at the midpoint, that would imply, I think, around $500 million of less underlying profit. Is that driven more by investments in the business relative to tax savings? Or is that more kind of on the underlying profitability of the PNC business?

Thomas Joseph Wilson
Chairman & CEO

Jay, first, we don't pick the midpoint as the specific target we're shooting for. We just say we can be in that range. And so as you know, it varies. When we do it, we obviously look at our current results, which you mentioned. We're also looking at the future additional investments we're making. As you know, frequency and severity can vary by a couple of percent each every year, if you just look at this year, what happened with our frequency declining or what happened in 2015 on the flip side of that. So we think this is a very attractive return on capital at these levels, and the best way to do is to continue to grow shareholder values to grow the top line.

Jay H. Gelb
Barclays PLC, Research Division

Okay, that's helpful. And then my follow-up question is, I know you mentioned it in the release, but the effective tax reform on our approval states for auto insurance like California, if you could give us a bit more insight on that based on the regulators' comments, I think that'd be helpful.

Thomas Joseph Wilson
Chairman & CEO

Yes. First, thank you for asking the question. It's a good question that came up in many of your -- the analysts' reports. The headline, of course, is, as we said, we don't expect any material impact on profitability returns as a competitive position, but let me give you some context below that. Obviously, some states have more restrictive pricing regulations. And obviously, we have to fully meet their requirements. And pricing, in those cases, would be impacted by a lower tax rate, but that's the not the complete picture, right? So the biggest component of pricing is, the biggest component there is loss costs, and they're not impacted by the tax rate at all. And if you just look around the industry in auto insurance, for example, you're talking 70% to 75% of premiums are in that category. And you have about another 20% to 30%, depending on the company, that shows up in expenses. And those also are impacted by the tax rate. So the biggest component's not impacted by that. I think people are a little confused by this letter that was put out by the Consumer Federation, which you just got bad math. So they report that it will be a $25 billion reduction in premiums on what's a little over $0.5 trillion of premium. For that to be true, with this tax rate change, the combined ratio, the combined ratio, not the loss ratio, would have to be in the low -- maybe even below the 70%. As far as I know, I'm not seeing any industry numbers that shows combined ratios below 70%. So I think what happened is that pushed, got people concerned about it. To the extent that lower taxes are also reinvested in the higher expenses, that's also reflected in your ratings. So what we did was we looked at the auto and homeowner pricing that Glenn and Matt looked at 300 combinations of states and companies, and we factored all that in. And we think our outlook factors all that in. We're getting great returns at that level. So we're comfortable that the tax cuts give us some more opportunity to grow our business rather than have a negative impact on profitability.

Jay H. Gelb
Barclays PLC, Research Division

That's helpful. So it sounds like some people over kind of view the -- or the impact isn't as nearly as hurtful as some people think?

Thomas Joseph Wilson
Chairman & CEO

I can't speak -- I looked at CFA's letter, I couldn't get to their math. Maybe they have a different way to do it. But I can just tell you that when you're on -- if you think of auto insurance, and let's just assume you have a 5% underwriting margin, it's a little hard to turn that into a 5% reduction in premiums.

Operator

Our next question comes from the line of Paul Newsome from Sandler O'Neill.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

I was hoping you could give us a little bit more color on the investments that you're going to make. And what exactly is going to be accelerated? And if there's any way to give us a sense of sort of a magnitude of the impact of those accelerated investments?

Matthew E. Winter
President and President of Allstate Insurance Company

Paul, it's Matt Winter. Thanks for the question. Last quarter, before we even knew about this, I've talked about the 5 buckets of initiatives that we had within the Allstate brand to drive new business growth. And I'll just remind you that, that included things like increasing distribution capacity. And that is points of presence, additional EAs, additional LSPs, especially in under-penetrated areas, and we will certainly be investing in additional distribution points of presence. Some of -- growing distribution points of presence has always been a great way to stimulate growth in the business. It's also expensive because they have enhanced compensation programs, and there's cost of starting those agencies. But we believe now that, that investment is a great opportunity for us, so you should expect to see that distribution capacity increase. On the second area, I talked about is making distribution more productive and efficient through things like technology, data and analytics, improve lead generation and more sophisticated segmentation, and we certainly believe we have opportunities to invest in all those areas, I would say specifically in the technology and data analytics area, where we have made great strides. And we see a lot of opportunity for increasing fairly dramatically the productivity and efficiency of our agencies and their personnel, their licensed sales professionals. The third area I talked about was getting the distribution system more engaged and investing their own money in their businesses through redesigned compensation programs and additional support and coaching. And those are already in place. And we expect our new compensation program to stimulate not only additional growth, but a deepening of the book, better customer service, better customer experience, and therefore a longer tenure of customers. The fourth area I talked about was more competitively priced and higher valued products using different pricing techniques and better underwriting to improve those rates. And we see an opportunity to invest some of these money in a few areas to both improve value of the products and the ease of understanding those products and selling those products. And so we intend to use data and analytics to do a lot of pre-fill, to do some propensity modeling, to help customers understand what other customers like them tend to purchase to help them make intelligent choices about the options and features in the product. And we see a lot of our opportunity to go from just offering really solid value products to doing it in a way that is remarkably easy and effective for our customers. And the fifth area I talked about last quarter was driving more quotes with more segmented marketing. And we certainly expect to invest some of the additional money in marketing. But it's not just throwing more money at the same marketing media, it's using increased segmentation, focusing on digital marketing capabilities, social media and some of the tools available to us now to enable us to better target the right customer for us. So there's a wealth of different ways to invest this money to stimulate growth in the business. And we believe it's a complex system. We don't believe any one single lever is ever effective in stimulating long-term growth, and we expect to pull as many levers as we possibly can to stimulate growth at the right level of margin to create long-term profitable growth.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

So is it fair that sort of 1, 2, 3 and 5 would be something that would be show up in the expense ratio? And I guess, 4 would show up in the loss ratio? Or will there be more competitive products?

Matthew E. Winter
President and President of Allstate Insurance Company

Well, look, certainly, increased investments could show up in the expense ratio, assuming you're not able to self fund then. But a lot of the work that we're doing is increasing productivity and efficiency in a way that allows us actually to improve our expense ratio, and then reinvest some of those savings in other techniques to drive growth. So some of it will potentially show up in increased expenses, but not necessarily 1:1 in the expense ratio. And don't forget, expense ratio is just that. It's a ratio. So the more we're able to grow the denominator, the less pressure there is on the ratio itself. As far as the loss ratio, our expectation is that we made tremendous improvement over the last several years in our ability to manage loss costs, both through very good improvements in the claims operation as well as in more sophisticated underwriting techniques and segmented rate-taking. We don't expect anything that we're doing to turn any of that negative. We expect to make continued improvements on the loss ratio side.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Congratulations on your retirement, and congratulations to everybody on their new positions.

Matthew E. Winter
President and President of Allstate Insurance Company

Thank you, Paul.

Operator

Our next question comes from the line of Sarah DeWitt from JPMorgan.

Sarah Elizabeth DeWitt
JP Morgan Chase & Co, Research Division

Your ROE for 2017 of 13% is very impressive, given the elevated CAT this year. What do you view is the right ROE profile going forward, given more normalized CATs, and now you have tax reform?

Thomas Joseph Wilson
Chairman & CEO

Sarah, thank you for the comment on it. Yes, 13% is a good number. It should be in the low teens. You can decide where in the low teens that will be. It obviously varies by year and by about -- 2 of it. I think you've pointed out an important fact, which is our homeowners business, the underwriting income was down about $400 million this year because of those high CATs, which was we've only had 3 years. In the last 10, we've spent about $3 billion. And so that had a big negative impact. And while we benefited, of course, from last level of frequency in auto insurance in the prior reserve releases that was -- it was a cost we had to overcome. It may or may not be during the future. I think the fact is with this balance we have between auto, home, investments, our life businesses and the other business we're starting, it should create overall profitable growth and give us good ROEs.

Sarah Elizabeth DeWitt
JP Morgan Chase & Co, Research Division

Okay, great. Thanks. And then just on U.S. tax reform. I'm just a little confused by some of the comments. I guess, how much of tax reform do you expect to drop to the bottom line? Because on the one hand, you say the future on filings will be impacted, but then on the other hand, you said they'll be immaterial. So will any of that benefit drop to the bottom line?

Thomas Joseph Wilson
Chairman & CEO

Well, we've -- first, there's not really any specific number, right, because you're talking about a system where there's all kinds of different components. So it's not like it just goes through. Think of taxes as expenses if you want to think about it that way. And Matt talked about how we have -- we're cutting expenses in some areas to invest in other things like marketing and distribution. But just think of this as another expense reduction. And so some of it we can invest in marketing, some of it we can invest in margin. It really just depends. We're trying to toggle between maximizing shareholder value between profit and growth. And clearly, we think that the best way to drive shareholder value in 2018 is by growing because we like where our returns are. So to accept some of it came through to the bottom line, that will be good for shareholders. We feel confident about our results, which is why we increased the dividend by 24%. I was actually kind of disappointed that none of the early stuff will regrow back to 24%. I'm like, "Hey, what happened to the dividend?" But -- so we feel good about the business and the returns that will generate.

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 is on the underlying margin target. If we look at the difference between the old segmentation and the current segmentation, that was about a 70 basis point impact on 2017. So do you effectively -- if we add that back then, is the 86% to 88% more or less in line with the target where you saw '17 at the start of last year? And then combined with that, when you think about and you come to this 86% to 88% target, could you walk us through how you're thinking about the deterioration that you could see in both the underlying loss ratio or the expense ratio as you came up with that holistic number?

Mario Rizzo
Executive VP & CFO

So thanks, Elyse. This is Mario. So first, the 86% to 88% is a total Property-Liability number. It's not unique to any one of the businesses. I think when you look at it compared to the 87% to 89% over a year ago, it -- we do expect improvement relative to the guidance we would have given you a year ago. Some of that is because of the continued profit improvement in some of the businesses that we've been working on profitability for the last several years. That would include Encompass and Esurance as well as our commercial business. So we factored that all in, and the outcome is the 86% to 88% that we gave you. And as Tom mentioned earlier on, we think at that level, with an outlook for accelerating growth, we can generate significant shareholder value operating the business at those levels.

Thomas Joseph Wilson
Chairman & CEO

Let me just make a quick comment about the frequency. So remember, in 2015, frequency jumped way up. We were all surprised. We got on it early, and we went to written prices. Previously came way down in 2017. So we haven't forgotten about that volatility when we're doing our estimates.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay, great. And then I know some of the questions that are all in the call did focus on the impact of tax reform and potentially on rate filings. But maybe this a little bit backwards-looking, but the level of rate that you guys took in the fourth quarter did go up a little bit even if you exclude the rate that you -- x kind of a rate increase that you guys took in California. I had thought that we might see a little bit of a slowdown in the rate level. Was there anything specific to the Q4, and just how we should be thinking about the level of rate you guys see yourself taking in 2018?

Glenn T. Shapiro

President of Allstate personal lines

Elyse, this is Glenn. You're right. It was heavily influenced by California, the higher rate in the fourth quarter. And that rate is effective now and in process. So we continue to look at our rates on a state-by-state basis. And going back to the question which you went into on taxes, that the -- only the profit component is impacted by the tax changes. And we look on state-by-state basis. And we have indications in states. This will be good for customers. It helps mitigate the indications, but it doesn't eliminate them. And we also factor in loss trend, which in and of itself is, every year, a larger factor than the tax change that we had.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. So you see yourself, I guess, similar commentary to last quarter, with a little adjustment for tax reform as more or less taking weight in line with trend?

Matthew E. Winter
President and President of Allstate Insurance Company

Elyse, it's Matt. Let me just add one thing. You made a comment about the deterioration in the margin that you saw in the fourth quarter. I would just encourage you to go back over the last however many years you'd like to, 3, 5, 10 years. And I think what you'll notice is that there is almost always historically an increase in the underlying loss ratio in the fourth quarter typically due to bad weather patterns that we see in fourth quarter and first quarter. And I think what you'll find is that our actual performance this last quarter from both an underlying loss ratio and underlying combined ratio was actually quite good. So we don't look at that as a deterioration in our underlying margin, we look at that as normal seasonality and volatility in that area. In the expense component you also referred to, you'll also see that following really good years, you will see a spike-up in the expense ratio in the fourth quarter, and that's typically due to our true-ups of our agent bonus plans and our employee incentive compensation plans. So that tends to be somewhat volatile. It's not a deterioration in our expense efficiency in the business, it's just reflecting a true-up in some things as a result of having a good year. So I would, if I were you, look at fourth quarter as a negative. In any way, we view it as a strong quarter with good strong fundamentals in both areas.

Operator

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

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Sorry to beat a dead horse here, but I want to go back to the guidance for the underlying combined ratio. So if we take the midpoint of that guidance, it's about 200 basis points higher than the total results for 2017. And if I understand the comments that you made on the call correctly, really a lot of the acceleration of expense initiatives would be offset by improved productivity. Some of the loss ratio increases could be offset by some of the loss control that you've put in the last couple of years. So what would drive that 200 basis point increase? Is it basically frequency?

Thomas Joseph Wilson
Chairman & CEO

Well, first, let's make sure we get everyone there. So if there's still questions out here, we feel very comfortable we can be in the 86% to 88%. We've picked a range that we feel is reasonable, one that we can live with then. We don't necessarily pick it just by the midpoint. So that's where want to be. We just said we want to be in that range. If you look at frequency last year, it was down 4% to 5%, depending on where you want to look at it. If you look at where were in 2015, you can get the same part of that. And so that translates directly almost -- percentage into -- it's probably about -- I guess, it's -- about 75% of it shows up in the combined ratio. So you can get year-to-year swing on frequency. Just bad weather, people getting into more accidents, the whole, with an increased miles driven, the new cell phones, what was it in 2015, we know that they happened everywhere around the country. We know other people were impacted by it as well. And so I don't think anybody can really do attribution on exactly why it happened. So I would just say that it's normal volatility in there. But I think the broader message is we feel really good about where our profitability is right now, and we think the right way to drive shareholder value is through growth. And we think -- so you won't see as many price increases that's come up next year because at these kind of margins, it's a very high return on required capital for us. And we can drive a lot of shareholder value by growing our business here. You're starting to see that in the -- particularly in the Allstate brand in auto insurance in the fourth quarter, which we started earlier in the year. So you're now starting to see that come through. It hasn't turned into year-over-year growth, but I believe we're headed in that direction if we can keep retention where it is, we keep driving new business. So this is about shareholder value. I think if you just want to get focused on profitability and not think about growth and shareholder value, then I would say probably the better place to go is to look at the trade-out between auto and homeowners insurance. And as I said, auto insurance profitability was up this year. If you're worried about that, look at homeowner profitability. When you add in CAT, then you get the total profitability. We use underlying combined ratio just to give you a sense for how well do we think the business is running. It is typically a 2-point range. Sometimes, with 1 year or 1.2 years, we move to a 3-point range because the market was a little more volatile, and we weren't sure how many price increases we can get. But 2 points is the range we think we can live within.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay, that's helpful. And if I could ask one more question about tax reform and the impact on the profit provision component of rate filings. So if I understand correctly, ultimately, in most cases, you actually file for a rate increase that is lower than the profit provision. Is that true? And if so, wouldn't it mean that tax reform ultimately would have very little impact on the actual ability to push forward rate increases if it were necessary?

Thomas Joseph Wilson
Chairman & CEO

I'm not sure I was with you on file for a rate increase lower than the profit provision. What do you mean by that?

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

So I think in most cases, you have an indicated rate that is dependent on the profit provision.

Thomas Joseph Wilson
Chairman & CEO

I understand what you're saying. So first, it's just that we operate in 50 states, and each of those states has its own regulatory environment. There was a good report done, I think, earlier this week or last week on which states are in which category. And so some are very restrictive and really look tough, hardheaded. Others, it's sort of an open market and you go to compete. In those ones that are very restrictive, you have indications of rates. And sometimes, you file for the whole indication. Sometimes, you get less than that because you're in a negotiation with the regulator as to what to do. So I would say, you're correct, and that it is a -- it's more complex than, "Oh, I'm going to take your underwriting margin." Time has changed in tax rate and say, "That's what happened to your premium." Much more complex than that. It's what we want to take, what the competitive situation is, where the regulatory environment is, where loss costs are, what trends are. It's a complicated little beast. We have 300 different companies and state combinations. And the bottom line is, we feel okay about where we're at. We think, with this tax law, it gives us an opportunity to invest in growth. We think that's really good for our shareholders. And so we're excited about this, not concerned about it.

Operator

Our next question comes from the line of Bob Glasspiegel from Janney.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Matt, congratulations on your retirement. A quick question on looking back to 2017, if we could just have one more look at sort of your underlying combined ratio versus target, which came in a couple points better. It sounds like, in your answer to Yaron's question, frequency was a big surprise, but what else sort of surprised you about the year relative to where you were setting it up?

Matthew E. Winter
President and President of Allstate Insurance Company

Thanks, Bob. It's Matt. Well, look, we had frequency surprise us when it's been positive, and we've had frequency surprise us when it's been negative. The frequency improvement was due this year to a lot of the things that are external and some things that are internal. So externally, the industry has experienced a decline in frequency. And we look at it with the same level of rigor that we looked at it when it went up. So it's consistent across risk segments. It's consistent geographically across rating plans, across customer tenure and accident types. So both quality and tenure of the customers appears to not be driving that. But when we reacted to the frequency spike at the end of '14, '15 and early part of '16, you recall that we took segmented rate. And because we took segmented rate, we impacted the riskier sections and segments of our book more than others. That increased defection rates of those underperforming segments. We did drive down lower levels of new business that actually reduced the new business penalty. And at the same time, we improved the rate adequacy of all the business that we drove. So it's the combination of the decline externally and some of the actions we took internally that really improved our frequency results. And you see that -- if you look at fast track, you can see us following industry trends, but better than industry trends. So we've been at least 0.5 lower than the industry for PD frequency in each of the last quarters, the last 4 quarters. So we're not seeing anything dramatically different than the rest of the industry, but I think we are benefiting a little better than everybody else from it. We also, in addition to frequency, remember that there was a whole lot of good work done in the claims organization to manage severity costs and loss costs through some of the work that they did with QuickFoto Claim, enhance discipline and diligence around bodily injury requiring enhanced documentation. And things like that and the result of all of that work has resulted in an improvement in our overall underlying combined ratio. And we see nothing to indicate that, that should be different for us going forward other than normal volatility that's environmental. But internally, the same stuff that's worked for us in the past should work for us going forward.

Operator

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

Joshua David Shanker
Deutsche Bank AG, Research Division

Yes, thank you for fitting me in. I appreciate it. I just want to clarify, on Elyse's question, the 86% to 88% guidance compares to an 84.9% in 2017 or an 85.6% in 2017?

Mario Rizzo
Executive VP & CFO

Josh, this is Mario. The comparable number would have been the 84.9%. That's on the same basis that the 87% to 89% was established. The 86% to 88% is based on the new segments.

Joshua David Shanker
Deutsche Bank AG, Research Division

And I guess, tangentially, can you tell us the difference in customer acquisition spend between 4Q '17 and 4Q '16? And maybe that will help inform us about how much you're willing to spend on acquiring new business in 2018.

Thomas Joseph Wilson
Chairman & CEO

Well, we don't break -- we don't disclose customer acquisition cost per policy. We obviously track it and use it. I mean, we just talk about marketing expenses. So in the fourth quarter, expenses were up a little bit in part because of the foundation and the agency comp Matt talked about. And it's probably -- even if you allocate it across the agency comp pressed here is probably about 0.7 point, something like that. And so we wouldn't expect that to continue at that level. That said, we are going to increase marketing in 2018 when we reposition our brand. I feel like our advertising needs to be refreshed a little bit. And so we're working on that for both the Allstate and Esurance brands. When we do that, we will invest in more marketing. What I can tell you, Josh, is that it's all economics. So we don't spend money to drive growth to lose money. We will accept a higher loss ratio on some new business until it ages out. So we can end up running a combined ratio loss on new business for our first year in both businesses, both Allstate and Esurance. But we don't -- it's all economic. We're all going to get quick returns on it. So the -- I think the point on sort of where are you, we were down a lot in frequency in 2017. We'd like to think this is a new level, and that our pricing that we've put in place in 2015 and 2016, which reflected higher frequency, was no longer necessary. And if that's the case, we're going to offer our customers a better deal. We can catch our margin. And we can grow, which will drive shareholder value. But the fact of the matter is, you don't know. And so I think the message we would like you to take away from 86% to 88% is that we feel good about the business. We feel good about the profitability of the business. We have good control over the profitability of the business to react to different things that happen in the marketplace. And the best thing to do is to keep profitability in that range and grow the business as opposed to drive the profitability lower. Obviously, you could -- we could have an alternative plan, which would be to drive the underlying combined ratio down farther. We do not think that that's the right way to drive shareholder value in the company. We think we've gotten ourselves through the dramatic increase in frequency in '15 and '16, and it's time to grow again.

So let me just close by, we had -- we talked and believe this is great operating results. We're positioned for growth. We have a 24% increase in the dividend, and shareholders continue to get repurchased cash as well, which positions us in a positive light. And we have a bright future. So thanks 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.