S&P Capital IQ

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The Allstate Corporation NYSE:ALL

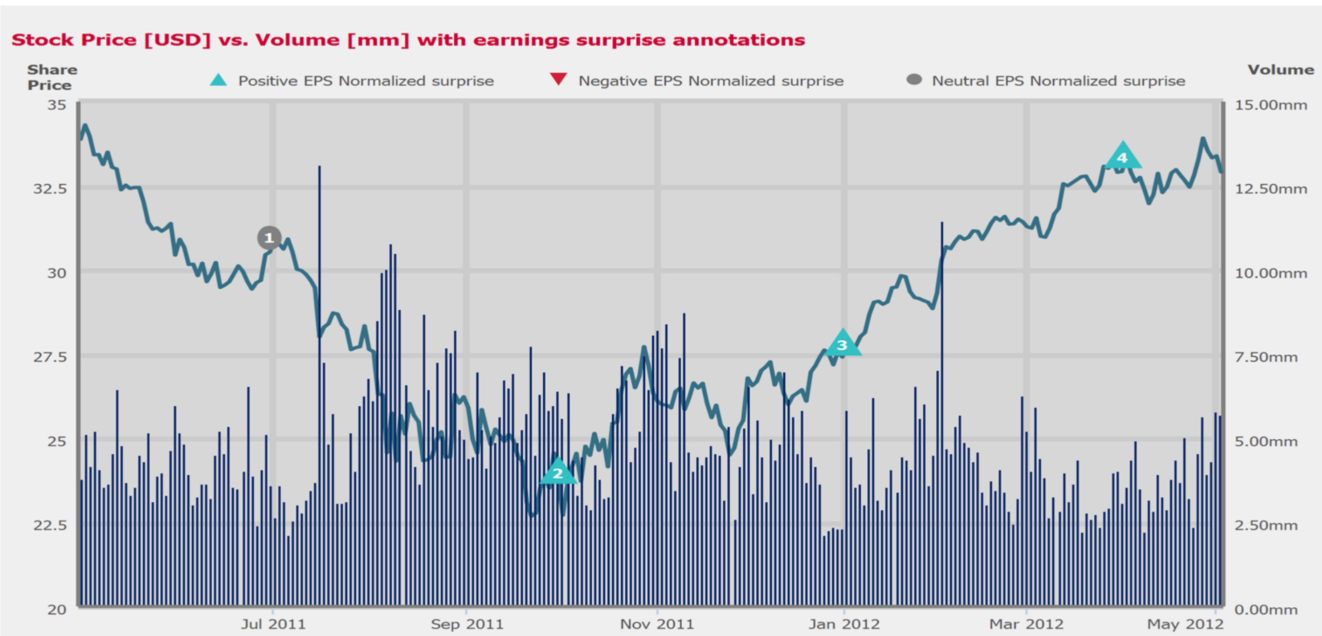
FQ2 2012 Earnings Call Transcripts

Wednesday, August 01, 2012 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2012-			-FQ3 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.57	0.87	▲52.63	0.80	4.00	4.29
Revenue (mm)	6716.31	6666.00	▼(0.75 %)	6758.60	26727.01	26969.21

Currency: USD
Consensus as of Aug-01-2012 12:13 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2011	(1.55)	(1.23)	NM
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 %

Call Participants

EXECUTIVES

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President of Emerging Businesses - Allstate Insurance Company

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

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Presentation

Operator

Good day, ladies and gentlemen, and welcome to The Allstate Corporation Second Quarter 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 of Investor Relations. Mr. Block, you may begin.

Robert Block

Thanks, Matt, and good morning, everyone. And thanks for joining us today for Allstate's second quarter 2012 earnings conference call. As usual, we will begin today with some prepared remarks from Tom Wilson, Steven Shebik and me, followed by a question-and-answer session. Don Civgin, Head of Allstate Financial and Insurance; Judy Greffin, Chief Investment Officer; Sam Pilch, Controller; and Matt Winter, Head of Auto, Home and Agencies are here as well.

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

Referring to the first slide of the presentation, this discussion may contain forward-looking statements regarding Allstate's operations. Actual results may differ materially from these statements, so please refer to our 10-K for 2011, our 10-Q for the second 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. I will be available after this call to answer any follow-up questions you may have.

Now, we can begin the discussion of our results with Tom Wilson. Tom?

Thomas J. Wilson
Chairman & CEO

Well, good morning. Thanks for your interest in Allstate. My remarks will focus on our performance relative to our 2012 priorities within the context of our consumer purpose strategy, and then Bob and Steve will cover their quarter's results in greater detail.

So let's begin on the top of Slide 2. As you know our strategy is to provide unique protection products to each of the 4 consumer segments in the marketplace. The Allstate brand, which is in the lower left serves those customers that want local advice and assistance and prefer to purchase competitively differentiated brand of products. In this business, we're successful in introducing new differentiated products such as our Claim Satisfaction Guarantee, Good Hands Roadside, and House & Home, our support of Allstate agencies and marketing programs continue to be expanded with good results, premiums written though were flat for the Allstate brand as our efforts to raise returns in homeowners, negatively impacts retention of home owners, and we have lower new business sales of auto insurance. We did increase the emerging businesses and Allstate Financial products sold through Allstate agencies.

The lower right customer segment is served by Esurance, which we acquired in October to give us a growth platform for self-serve customers that prefer our brand of product. We continue to believe our capabilities will make us a more powerful competitor and policies in force are up this year. The results of Encompass and Answer Financial also improved this quarter. Our 4 2012 priorities are to create shareholder value by: one, maintaining auto profitability; two, raising returns in homeowners and annuity businesses; three, growing insurance premiums; and fourth, proactively managing investments and capital.

So moving to Slide 3. We had another very good quarter with financial results showing progress in our priorities. On a consolidated basis, we reported net income of $423 million and $432 million of operating income, both significant improvements for the net and operating loss posted last year in the second quarter. The improvement was driven by lower catastrophe losses and a favorable reduction in the underlying combined ratio. While catastrophe losses this quarter were reduced from last year's record second quarter, this quarter's losses were still high versus the long-term average. It reaffirms our 2008 decision to focus on improving returns in our homeowners line.

Book value per share has increased 9.8% this year reaching almost $40. Return on equity for the last 12 months increased 11% on a net income basis and with 11.4% on an operating basis, getting closer to the 2014 goal of 13%. Good progress is made on our 2012 priorities as well. We maintained auto profitability with the Allstate brand standard auto combined ratio of 95.5, which is better than last year's second quarter. Esurance's combined ratio increased, largely reflecting higher advertising expenses, acquisition cost, amortization and catastrophe. There was modest upward pressure on auto loss cost, but this is well within our pricing parameters. Homeowner returns continued to improve with an underlying combined ratio of 64.6, which was 4.8 points better than last year's second quarter. This reflects both our long-term effort to raise prices and improve underwriting selection as well as the moderation of loss cost. We're pleased with the results but recognize there is more work to be done until returns are adequate and sustainable.

Allstate Financial's annuity returns were essentially unchanged economically, but the reported results were higher largely as a result in shift in the location of income from limited partnerships.

Overall, Allstate Financial had $138 million of operating income, which is comparable to last year's quarter on a slightly smaller asset base. Insurance premiums increased in the quarter by 3.8% from the prior year, largely reflecting the acquisition of Esurance and increases in emerging businesses and Encompass. Esurance's policies in force have increased by 13.5% since the beginning of this year, as our new advertising and pricing sophistication resulted in economically attractive growth. The investment portfolio had a total return of 1.8% in the quarter with a small increase in investment income, $27 million in net capital gains and a $442 million increase in unrealized capital gains.

We remain focused on balancing returns and preservation of capital by favoring intermediate corporate credit investments in this low rate, unstable economic environment. We also repurchased $275 million of common stock in this quarter. All in all, good progress on all 4 priorities. Bob and Steve will now provide more detail on the various components of these results.

Robert Block

Slide 4 provides our net premium written and combined ratio for property liability. Overall, premiums written of $6.86 billion grew 3.8% compared to the prior year, a growth rate similar to that of the first quarter 2012, driven primarily by our acquisition of Esurance which continued to grow both premiums and units, as well as positive growth experienced in both the Allstate and Encompass brands. Allstate brand's standard auto net premium written of $3.9 billion declined slightly from the prior-year quarter as auto profitability actions taken in New York and Florida, coupled with actions to improve homeowner returns, continued to hamper overall growth. Excluding New York and Florida, net premiums written for the Allstate brand's standard auto grew slightly from the second quarter 2011. The drop in units was partially offset by an increase in average premium. Retention at 89% was down 2/10 of a point from last year's quarter driven by declines in New York and Florida, with the rest of the country increasing slightly.

Allstate brand homeowners net written premium of $1.64 billion increased 2.1% from the second quarter 2011. Rate actions designed to improve homeowner returns more than offset the decline in units as average premiums increased 9.2% in the quarter compared to the second quarter of 2011. In the second quarter, we received approval for rate changes in 7 states averaging 10.2% worth 1.2% on a countrywide basis. In addition to the rate actions, we have introduced our new product, called House & Home, in 9 states, 7 of them in the second quarter of 2012. We're pleased with the results thus far, as early results indicated we are getting a little lift in new business acquisition for both the homeowners and auto insurance.

Within the Allstate brand, the other personal lines, which comprise emerging businesses, posted net written premium growth of 1.8%. We also experienced net premium written growth in Encompass of

5.9%, driven by a substantial increase in new issued applications as well as increased retention ratio. Sequential growth in policies in force was achieved in emerging businesses, Canada, Encompass and Esurance.

On the bottom half of Slide 4, the recorded combined ratio for property liability was 98.0%, a significant improvement from second quarter 2011's 123.3%. A lower catastrophe loss and an improved underlying combined ratio were the primary reasons for the favorable results. The underlying combined ratio was 86.3%, a 1.2 point improvement from the second quarter 2011. Seasonally, the second quarter has produced the lowest underlying combined ratio in every year since 2005.

Moving to Slide 5. We provided the loss trends for Allstate brand's standard auto for the last few years. The top half of the slide displays the gross frequency and paid severity for bodily injury and property damage coverages. After 4 quarters of frequency reduction, both bodily injury and property damage frequencies increased from prior year by 1.9% and 1.4%, respectively. Paid severities for bodily injury and property damage also increased by 3.4% and 3%, respectively. While this represents a modest increase in loss cost for these coverages, when you include the results for the other coverages, coupled with the impact of an increase in average written premium, the underlying combined ratio improved slightly to 93.4% from 93.7% in the second quarter of 2011. We continued to gain approval for rate changes this quarter with 19 states approved at an average in those states of 4.4% for a countrywide impact of 1.5%.

With maintaining auto profitability being a key priority for us, we added the next slide to give you a longer-term view of this key metric. Since 2001, we have produced strong profitable underwriting margins in the Allstate brand standard auto, averaging a combined ratio over the last 11 years of about 93%. The chart in the bottom of the page gives you the underlying combined ratio since 2008 by quarter and year. While there are some seasonal fluctuation, the pattern of profitable margins is evident. It has been, and will continue to be, very important for us to maintain auto profitability.

Before moving on to homeowner loss trends, we made a commitment to you to provide an update on Esurance. Details for Esurance underwriting results can be found on Page 24 of our Investor Supplement. Growth accelerated in the second quarter with premiums written of $224 million. Keep in mind that seasonally, the first quarter tends to be the highest quarter of the year in terms of premium volume. Policies in force through the 9th [ph] are $892,000, up 13.5% since year-end 2011. The underlying combined ratio was $106 million, including 16.2 points of advertising expense. The reported combined ratio for the quarter was 116.7. Overall, Esurance is performing as we expected.

On Slide 7, we provided charts on homeowner rate activity, loss trends and profitability. In the upper left, we show the countrywide rate effect of the approved rate actions over time. As I mentioned previously in the second quarter, we received approval for rate changes in 7 states averaging 10.2% worth 1.2% on a countrywide basis. So over the last 4 quarters, we have averaged over 8% on a countrywide basis, a level consistent with the last few years.

In the upper right, we displayed the frequency in paid severity trends excluding catastrophes. In the second quarter, frequency declined 6.7% compared to the prior year while paid severity increased 2%. Given these modest loss cost trends, coupled with approved rate actions, the underlying combined ratio shown on the lower left declined by 4.8 points to 64.6%. The combined ratio, the reported combined ratio for the second quarter was still unprofitable at 104.9%. We'll continue to focus on improving the margins in homeowners.

Taking a closer look at the underlying combined ratio for Allstate brand homeowners on the next slide, the top chart provides the results for the underlying combined ratio by quarter. The underlying combined ratio began to improve in the back half of 2011, and continued into the first 2 quarters of 2012. The chart on the bottom of the slide provides some insight into this improving trend. It plots the percent increase in the average earnings versus the underlying loss trend. It also answers the question, "With all the rate increases Allstate has taken, why hasn't the underlying combined ratio improved faster?".

First, looking at the earned premium line in red, we observed that the increasing trend beginning in early 2011, one that is more reflective of the approved rate action levels. It takes time for the rate changes to be earned because it's an annual policy. Second, the loss trend in blue, essentially matched the change in year average earns so the underlying combined ratio didn't show much improvement until the last 1.5 years. So the improvement we've experienced in the underlying combined ratio was driven by rates being earned and by favorable loss trends.

Results for Allstate Financial on Slide 9 are reflective of our efforts to improve returns while shifting the focus from spread-based to underwritten products. In the second quarter, total premiums and contract charges increased 2.2% from prior year with underwritten products up 3.1% from the second quarter of 2011. Allstate agencies increased life unit sales with issued policies growing 2.5% compared to the prior-year quarter. Operating income of $138 million increased 2.2% from the prior year, helped by the inclusion of equity method limited partnership results this year, as well as lower crediting rates that were partially offset by worse mortality in both life insurance and annuities, lower yields on fixed income securities, and the continued managed reduction in spread business.

Net income of $132 million declined relative to last year, driven by a reduction in net realized capital gains. Operating returns on attributed equity were relatively consistent with the first quarter 2012 levels. Life insurance returns were at 10.8%, accident and health were at 16.3%, and annuities came in at 5.9% as of the end of the second quarter. The overall return was 8.7%, 4/10 of 1 point better than year-end 2011.

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

Steven E. Shebik
CFO & Executive VP

Thanks, Bob. We continue to proactively balance portfolio yield and return objectives in this challenging, low rate market environment, delivering a total portfolio return for the second quarter of 1.8% on a GAAP accounting basis and 3.8% to the first 6 months of the year.

On Slide 10, we can see the size and composition of our overall portfolio. Improved fixed income valuations, portfolio income and positive cash flows from our Property-Liability business more than offset the ongoing managed reduction of Allstate Financial's spread business. These factors combined to raise the portfolio valuation to $97.3 billion at the end of the second quarter, compared to $95.6 billion at year-end 2011, and $97 billion as of the first quarter.

Our portfolio actions during the second quarter continue to focus on optimizing our fixed income portfolio position on the yield curve, shifting more toward the intermediate term part of the curve and favoring corporate credit over treasuries and equities. You can see the result of these actions, which reduces reinvestment risk, and will preserve capital when interest rates begin to increase in the asset allocation breakout as well as the scheduled maturity profile.

Slide 11 highlights portfolio income and yield trends. For the second quarter of 2012, net investment income was just over $1 billion comparable to the second quarter of 2011, and total portfolio yield was 4.6%, higher than the second quarter of 2011 and consistent with the first quarter of 2012.

Limited partnership results were the primary driver of the favorable variance to the prior-year quarter. You may remember that we've prospectively changed our classification of equity method limited partnership results to net investment income from realized capital gains at the beginning of the year. This brought us more in line with the reporting practices of our peers.

Investment income provided in limited partnerships was $107 million in the quarter, comparable to the total from the first quarter, and $89 million higher than the prior-year quarter. The increase reflects the change in classification as well as an improvement of $34 million in limited partnership performance. If our equity method limited partnership results had not been reclassified, second quarter 2012 net investment income and portfolio yield would have been lower than the prior-year quarter, as seen from the chart on the bottom of the slide, and consistent with the reduction in Allstate Financial's liabilities and lower interest rates.

On Slide 12, you can see that we've realized gains of $27 million in the second quarter of 2012, a decrease of $30 million compared to the second quarter of 2011. Our portfolio management actions and other trading activities generated approximately $70 million in trading gains in the sales of fixed income and equity securities, which were offset by $15 million in write-downs for the quarter. Impairment and intent write-downs continue to trend significantly lower than prior year periods. Derivative results reflect reduced usage as we are focusing the management of rate risk in the cash market to portfolio positioning on the yield curve.

We finished the quarter in a strong capital position as shown on Slide 13. Shareholders' equity of $19.5 billion increased $1.2 billion from year-end 2011. Statutory surplus for both Property-Liability and life remained strong, and deployable assets at the holding company level was $2.3 billion. We continue to buy back our stock, purchasing $275 million during the second quarter. That leaves $319 million on our current $1 billion authorization. Our book value per share hit a new high of $39.73 and the strength of our operating performance improved portfolio valuation and active capital management.
Now, let's open it up for your questions.

Question and Answer

Operator

[Operator Instructions] Our first question is from Bob Glasspiegel of Langen McAlenney.

Robert Ray Glasspiegel
Langen McAlenney

Quick question on homeowners that I've asked before. What inning do you think you are in the play in this business, and I guess, put another way, how many more quarters do you think we'll be hearing that aggregate premium growth or PIP growth was held by homeowners' actions. It seems like your underlying is getting close to the low 60s this quarter, and your -- I thought the relatively low cat ratio of 12 points versus your peers was an encouraging quarter relative to your cat management programs. So where do you think you are Tom?

Thomas J. Wilson
Chairman & CEO

Well, Bob, if nothing else, you're consistent, so thank you for that. As we said, look, this is a business we have about $6 billion of capital locked in. We're looking to get in the mid-teens kind of returns on our capital, so we, obviously, have a way to go. Matt can talk specifically about what we're doing. I will say, I feel very good about the results in the underlying trends we see. Clearly, we had a little bit of benefit, I think, lower fire losses and a few things this quarter, but the geographical focus Matt has brought to the business has been quite good, and he can talk about some of the things he has going there. So, Matt?

Matthew E. Winter
President and President of Allstate Insurance Company

Sure. Thanks for the question, Bob. I usually tell people if I could predict the weather patterns, both cat and non-cat, I could tell you what inning we're in. But until then, and since I can't, I can't really give you an answer to what inning we're in. I can tell you how we're approaching the business, though. This may not surprise you, but like politics, this business is entirely local and it's like playing a game of whack-a-mole at the amusement park, everywhere you turn, something pops up and you have to deal with it aggressively. And as Tom said, we've decided that trying to have 1 person with a club managing all of these interactions is impossible, so we pushed some of the decision-making down to the more local level and empowered local management, state managers and people who can watch individual geographies, not just by state but even within a state, to manage and react to trends very quickly as opposed to trying to manage them all from a centralized basis. And so, that has enabled us, I think, to react very quickly to trends as they emerge. So the things that we're watching pop-up may be somewhat unexpected but they're still manageable. And in some cases, we've been able to react so quickly that they don't even emerge as microtrends, much less macrotrends. So we'll continue to approach the game that way depending upon how weather pans out and how a couple of other factors pan out. We'll determine how soon we're through some of the stabilization mode and get into the growth mode that we all want to be in, but we know our task and that's to get rate adequate, manage our volatility, create a sustainable base for growth and then focus on that growth.

Thomas J. Wilson
Chairman & CEO

And Bob, I've been -- we're down about 200,000 policies in the homeowners, I think for 6 months, it's a close number. I don't think you should see that rate of decline change in the second half of the year, in fact it may be a little higher as Matt does some specific targeted actions we've talked about. So we feel good about it, but we're not there yet so we're not yet -- as Matt said, he's not ready to turn on the spigot just yet.

Operator

Our next question is from Vinay Misquith of Evercore Partners.

Vinay Gerard Misquith
Evercore ISI, Research Division

The first question is on the expense ratio, that's been kind of [indiscernible] which is a good thing. But any sense for -- any specific projects that you plan to reduce expense ratio?

Thomas J. Wilson
Chairman & CEO

I'll make that a general comment and then Don can speak about what we're doing in advertising and Esurance, and Matt can talk about the work he's doing. We, obviously, look hard at our expenses in all combination we expect, and we're always trying to reduce expenses and shift those to where we need to put them. Part of the reason for our increasing expense ratio would be the Esurance increased advertising. We also spent a little bit more money in advertising in the Allstate brand this quarter as well. Matt has a number of programs going on now to simplify and reduce cost. So Don, maybe you want to start, and then, Matt, jump into...

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Sure, Vinay. Of course, Esurance has a slightly different model, business model, than Allstate does, and so much of the expenses are acquisition related and charged upfront. And so, as we have grown the business and that growth has been pretty substantial here in the second quarter, with new policy sales are up over 30%. As that happens, what happens is you're expensing a lot of advertising expense upfront, which obviously has an impact on the -- expected impact on the combined ratio for Esurance. I would tell you the integration is going quite well. The other expenses are coming down as we expected them to, so we're getting the efficiencies and we're getting the savings we expected from the acquisition. We are intentionally spending the money on advertising, quite honestly, because the response has been so strong to it, and we're seeing some very solid growth. So you will see a tick up in the combined ratio, but what's important for you to understand is we are looking at this from an economic combined ratio, and if you allocate those acquisition expenses through the life of the contract, the business that Esurance is writing is combined ratio under 100, so it's actually quite attractive business. On a GAAP basis, it's going to raise the combined ratio for some period of time. But that's what happens with that accounting model and high-growth levels.

Matthew E. Winter
President and President of Allstate Insurance Company

Vinay, it's Matt. So I'll give you a little perspective on the expense ratio and how we're approaching it. We look at this as two prongs. We don't believe that you can manage the expense ratio just by managing down and cutting expenses because if you do that actually, you'll so constrain growth that you'll actually hurt the expense ratio. So we're trying to do a balanced approach to managing the expense ratio through targeted efforts on growth and pruning out all the unnecessary and non value-added expenses in the business, most of that is through simplification of workflows. So I have a team working with my back office right now focusing on removing handoffs, simplifying processes, dramatically reducing service level agreement times and taking out expenses through productivity, as opposed to reducing expenses through other efforts that might impact growth. So we're looking at this in kind of a balanced way. We think we're making some good progress on it, but we don't want to try to cut our way to success there, because we think it will be counterproductive in the long term.

Thomas J. Wilson
Chairman & CEO

Vinay, this is Tom. And if you look forward, and as I know you'll always do, as we look forward to next year, you should expect us to continue to compete aggressively in the marketplace, as both Matt and Don just talked about. We're also going to have to spend more money on technology because all of the customer segments we've talked about, whether they be the Allstate Agency, local advice and assistance, or Esurance are adapting to new technologies quickly. So we're going to probably spend more money on technology as we move forward next year.

Vinay Gerard Misquith
Evercore ISI, Research Division

Okay, that's helpful. This second question is on PIF. Could you help us understand how you're looking at PIF, as we get into the back half of this year and early next year, especially considering that the new commission structure for agents is going to come up to -- falls on January 1 next year?

Thomas J. Wilson
Chairman & CEO

Maybe I'll make a comment about all the different businesses. Matt can talk about the commission stuff, and maybe Matt, you want to talk about sort of the agency relationships, because that's related to it as well. So obviously, we expect Esurance to keep going, we like what we got there. Don talked about that. Encompass has started to grow but they got a long way to go to get back to where we were, so I'm hopeful they'll continue to push our package policy growth. The Allstate channel we've talked about at length in terms of the headwinds of the homeowners business and what's going on in New York and Florida, we should start to cycle through those. But I don't think you should expect to see dramatic growth in PIF there. Allstate Financial, we continue to make some progress on life sales and the Allstate Benefits business, and then you should expect to see the size, and it's not really related to PIF, but the size of the fixed annuity business continue to come down. We're down about 4% or $1.5 billion so far this year. We would expect that business to keep coming down, if you're just thinking about growth in total of the company. And Matt, maybe you want to talk about that commission structure, agency relationships?

Matthew E. Winter
President and President of Allstate Insurance Company

Sure. I want to make sure I understood the question so if this is not the answer to your question, please follow-up again. But you mentioned the change in commission structure as if that was going to impact PIF and our ability to grow and in reality, the primary change that's taken place in January is a simple variable comp piece that's been drawn in as part of the overall commission structure. And that variable comp piece, that 1%, is earned back by the agents through a series of fairly simple and very controllable actions on their part about physical presence and the location and what it looks like, having sufficient number of licensed sales professionals to support the agent, maintaining continuing education credits, and things that are manageable within their control. And in addition, they'll have the ability to earn an extra 1% based upon customer experience results and customer satisfaction through a survey. So I don't anticipate that the change in commission structure will impact PIF in any meaningful way. My expectation is that it will improve customer experience and align the interest of our agencies and the company and the policyholders together in a more productive manner. The collateral or tangential question you raised is agency relationships, and that has impacted PIF to some extent in that they have been distracted a little bit by the change in commission structure as they were learning it and trying to understand its impact and trying to figure out how to manage their cash flows. We have or had an aggressive agent reengagement strategy underway for the last several months. It began with a fairly massive gathering at the National Forum in Las Vegas where we had over 4,400 agencies present. And the best I would say over 40% of whom had never been to a national conference before, any time in their history of affiliation with Allstate. So we managed to pull together a bunch of people who do not typically have the opportunity to hear from management, learn best practices from each other and share and develop and that was used as an opportunity to give people a chance to ask questions about the new commission structure and the new bonus structure, to learn about it, figure out how they can maximize their own compensation and get their heads back in the game. It's been productive, it hasn't solved everything yet. We understand how important agency morale is. We know it's critical that they understand how much we believe in them, and how much we want them to be successful. And we will continue to work on it and align with them, and our goal and belief is that we can make these compensation changes in a positive way without negatively impacting anything.

Thomas J. Wilson

Chairman & CEO

We did a survey after the event, and the 80% to 90% said, "We feel good about the company. We think management understands us. We're feeling good about where it could go", so I'd rather be at 100%, rather than in the 80s and 90s, but if you look at a large geographically dispersed and diverse workforce, we recognize we have room to improve but it's also not as -- you have to listen to the broad set of opinions as opposed to just the noisiest ones.

Vinay Gerard Misquith
Evercore ISI, Research Division

Fair enough. Just as a follow-up to that. I mean, my concern was just that as you approach the January 1 date, you might get some more requests for dominations from agents, just because they don't want to move to a low commission structure. And should that affect the PIF? So that was really my question.

Matthew E. Winter
President and President of Allstate Insurance Company

Yes, well let me clarify. It's not a low commission structure. It's actually an opportunity to earn a higher commission through certain activities in customer satisfaction, and we believe strongly that once they understand that and see how achievable it is and they see their true earnings potential that it will actually be helpful to attracting and retaining more agencies as opposed to a catalyst for departures.

Operator

Our next question is from Jay Gelb of Barclays.

Jay H. Gelb
Barclays PLC, Research Division

On the return on equity goal of 13% by 2014, it seems like you're getting real close to that faster than I would have expected, and probably a lot of other people. Any -- what are your thoughts in terms of achieving that goal prior to 2014?

Thomas J. Wilson
Chairman & CEO

Jay, we're still 2 points and 19 billion away to go, and so we're talking about $500 million to $600 million by the time you sort through it all. And so we have some work to go. We still feel good about it. Obviously, we have a headwind, which when we made that projection of, interest rates are a lot lower. So we had to work our way through that but we still feel good about getting the 13% by '14. To the extent we get there sooner, will just make our shareholders even happier.

Jay H. Gelb
Barclays PLC, Research Division

Okay. And then on the underlying combined ratio guidance, I struggled to remember whether if it had come in better than your range, if you had changed the guidance over time?

Thomas J. Wilson
Chairman & CEO

I'm not sure, I -- so...

Jay H. Gelb
Barclays PLC, Research Division

It's coming in better clearly than in the first half compared to the guidance range? Do you -- is there a point at which you might improve the guidance range?

Thomas J. Wilson
Chairman & CEO

Yes, we put the guidance out there as 88 to 91, there's obviously a fair amount of bouncing around because of frequency, which can move a point on either way, which translates right into a point so I would say, a good frequency so far this year. It is a full year number, don't feel like changing it right now. And it's just one component of what we try -- and you know what? I would really ask you to focus on the 4 priorities we have, and see how we're delivering on those 4 priorities. We provide that guidance to help people do their analysis but as you're well aware, that is only a small piece of what overall results are. It doesn't include catastrophe, it doesn't include investing income doesn't include all of Allstate Financial's subs. There's a lot of pieces missing, so I don't -- I'm not inclined to change it right now because it's a full year number, but I like where we're at. I'm feeling good about the business right now.

Jay H. Gelb
Barclays PLC, Research Division

Okay. And then finally switching gears to property liability, net investment income, it was up pretty meaningfully on a link-quarter basis, $352 million versus $313 million, I realize limited partnership had a benefit there but the pickup in taxable non -- the taxable fixed income was also a benefit. So I'm just trying to get a sense of what do you feel of the right normalized quarterly run rate is there?

Thomas J. Wilson
Chairman & CEO

That's a complicated question. Maybe I can get Judy to talk about -- Judy if you'd talk about the difference and also what we've done in repositioning the portfolio into the intermediate part of the curve, what we do with equities and at -- at the end of the first quarter, and then maybe talk a little bit about the role and what we have going on over the next sort of 12 months that might help Jay get through his number. I don't think -- we're not going to give you a specific number, but Judy can you give those components which will help get you there.

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

So when you look at it with LPs and without LPs, you're right, we're doing okay in both. I'd say without LPs, it's stabilized as well. And as Tom mentioned, we're doing a lot in terms of optimizing the portfolio and one of the things we did in the first quarter, which we might have mentioned before was that we sold some equities and bought high yields, in the property and casualty company. We like that trade from an economic perspective and it also has helped on investment income on year-to-date and what we've also done is continue to optimize the portfolio on the interest rate curve. So over the past several quarters, what we've done is we've sold near-term maturities and sold longer duration maturities because we're still concerned about long-term interest rates eventually going up and where we've really focused our efforts in the intermediate part of the curve, 5 to 7 year maturities. So that helped us maintain our income but it also have helped preserve the income going forward because we'll have less coming off the portfolio than what we would have had we not done anything.

Jay H. Gelb
Barclays PLC, Research Division

I see, all right. So if I look at that $352 million for the quarter, was there anything in there you'd view as extraordinary in the quarter?

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

Except for the LPs, I think LPs are more difficult to project and we had a pretty good first quarter in the equity market and that might have pulled some of what we thought was going to happen throughout the year forward. And you have to remember that we've reported those on a lag and the second quarter equity market wasn't as good as the first quarter. So the LP component is going to be a little bit more volatile, but while we're focused on both, yet I think, we've also seen some stability because of some of the actions we've taken in the core portfolio as well.

Operator

Our next question is from Mike Zaremski of Crédit Suisse.

Michael Zaremski
Crédit Suisse AG, Research Division

So in the prepared remarks, the term moderate was used in regards to the rise in auto loss cost trends. But when I look on paper looks like the rise largely in frequency was somewhat steep. So can you provide color on what could be driving the increase and could you also comment on whether non-cat weather costs were lower this quarter versus 2Q '11?

Thomas J. Wilson
Chairman & CEO

So let me just get to the right page, so where you're looking at...

Michael Zaremski
Crédit Suisse AG, Research Division

I think on Slide 5.

Thomas J. Wilson
Chairman & CEO

Slide 5? And you're looking at the gross frequency numbers?

Michael Zaremski
Crédit Suisse AG, Research Division

Correct.

Thomas J. Wilson
Chairman & CEO

I would -- you can -- that's a percent change year-over-year, so I think -- maybe I'll make a general comment on that, we obviously tried to factor in severity and frequency into our pricing. Matt can talk about how he's doing that. I don't see anything particularly abnormal in the second quarter.

Matthew E. Winter
President and President of Allstate Insurance Company

So, it is true that you saw some unfavorable trends there but just remember that 2011 and the beginning of 2012 we're both at the low end of the historical down so the rise looks disproportionate but it is clearly within historical volatility downs. There are certain geographies that were impacted by xCAT weather which drove frequencies higher, such as Texas, where we had a bunch of issues. Not only was Texas the site of 3 of the 4 largest cats but also had a lot of xCAT weather that drove frequency. So as I said, we monitor the quality of our book on a fairly micro basis. As these emerge -- if we can't explain them, or they weren't predictable then we take immediate action to manage them. So we don't feel concerned about it, but we're certainly watching these as they emerge. But as I said, in an earlier response, I think some people have interpreted some of these as large macro trends and the more we look at them, they're very, very locally based microtrends that influence a larger number. Tom and I talk all the time about how averages lie and so we don't look at the overall average number. We look at the micro-targeted local numbers and those are within expectations and within historical bounds.

Michael Zaremski
Crédit Suisse AG, Research Division

Okay. And next, so $320 million left in the buyback authorization. Is that tracking ahead of expectations and would the board consider increasing the program before year end?

Thomas J. Wilson

Chairman & CEO

The -- it's a little faster than we had originally planned on. We thought the price is cheap. So we kept buying it back and we generated enough capital and have plenty of capital holding at the company level to do that, so we got on top of it early and aggressively. The way we do it is when we get close to the end of the program then we go back, and look at what we want to do a new one. But we typically finish a program then start a new one as opposed to sort of continually increase the size of the existing program. As you know, we've traditionally done that in February when we have a good read on statutory capital for the year and where it came out. Last year, of course, we accelerated that because we again, thought the price was cheap and we're buying it back. As soon as we get down with this one, we'll sit down on the board and look at it again. I think you should expect our philosophy to stay the same, which is if we have capital that's not being deployed in the business, we believe it's the shareholders capital and we will pay that back out to the shareholders. Largely we have done that through share repurchases over the last 15 years. And obviously, dividends eat up about $450 million a year as well.

Robert Block

And we do generally front-end load the programs a bit before the hurricane season. So if you look we've seen basic trends a year ago also.

Michael Zaremski
Crédit Suisse AG, Research Division

Okay and if I can still have bum last one in, it's a follow up to the previous question, caller's question. The new money fixed income yields, if you got a comment on that?

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

The reinvest yields, for Allstate Protection and Allstate Financial?

Michael Zaremski
Crédit Suisse AG, Research Division

Correct.

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

So for Allstate Protection, we target again the 5 to 7 year part of the curve, corporates. Right now, we'd say that's around 2.5 to 2 and 3 quarters and then for AF, it's longer than that, it's more of 7 to 10-year corporates, something over 3%. But remember in AF because the contract holder funds are coming down in the annuity segment. We don't have much reinvest risk there. Really, we're pretty well matched maturities versus what we expect will come off in terms of liabilities.

Operator

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

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Most of my questions have been answered but I was wondering if you could possibly give some commentary around what may be your seeing your competitors do, what the peers do in auto? We've heard them indicating severity pressure is a little bit more than you have, so are you seeing more rate actions there?

Thomas J. Wilson
Chairman & CEO

Alison, this is Tom. Matt might want to make some comments as well. We can't speak to specifically what their strategies are. Certainly, the decreases people were taking back in the '08 period of time, when we get -- we don't see people doing that. We see more modest small increases. If you look over a longer period of time, so if you look at our results from 2007 say forward to today, average premium hasn't really gone up much. We've done a much better job of getting our pricing right for our customers on an individual basis. Frequency has been down a little bit, severity has been up, modestly we've controlled it from our standpoint. I think some of our competitors have been recently talking about higher increases, but that's again back to Matt's point, averages lie. If they get a bunch of business in Florida and they messed up, then they've got a raise. I don't know, Matt, if you're seeing anything different in the marketplace.

Matthew E. Winter
President and President of Allstate Insurance Company

No, I can't really comment on the competitors. So I'll just continue to comment on our approach, which is I think really one of the benefits of our structure and the way we operate, which is the locally based decision-making and monitoring by both state managers, controllers, regional senior vice presidents, those teams are able to focus differently and focus more quickly when trends emerge. They also know, based upon the local geographies what to expect. So they know, for instance, when you aggressively push on BI or PIP in some states, BI will pop up next and they are prepared for that and they get ready for that. And so, all I can say is we are managing both frequency and severity and dealing with it through appropriate rate, correct class, the typical underwriting discipline that you would expect to see from Allstate.

Operator

Our next question is from Ian Gutterman of Adage Capital.

Ian Gutterman
Adage Capital Management, L.P.

Just a couple of follow ups. On the homeowners, Tom, and I think going back to investor day 1 year-or-so ago, the goal was toward the low to mid-60s underlying combined and you're at basically in mid-60s now and you're still taking a lot of rate and loss cost seem to be getting a little bit more favorable. Is it possible you would overshoot that and we could even see better than what your goal is?

Thomas J. Wilson
Chairman & CEO

Ian, thanks for remembering and I would say it's always possible, but probably not likely. One of the things impacting this year is mix. There's a lot fewer fire losses in the first half of this year. Fire losses tend to have very high average severity and so that can rattle through your paids. We also had some high number in paid in the second quarter of 2011. So the decrease is really, because of the loss, the decrease is not as big as it appears to be. So, I think the last quarter Matt said, you thought about 40% was sustainable, 60% was sort of one-time. I don't know what your percentage is this quarter. But I'd say we're happy where we're at, we like where we're going. If we overshoot given the volatility of this business, it's possible some quarters we could make lots of money, but as I think we've said at investor conference, our goal is to take this business from sometimes earning a profit to sometimes losing a profit to always making some money, sometimes a lot of money, not sometimes not so much money, but move it from the plus or minus category to the plus or plus, plus category so that we get a decent return on our capital.

Ian Gutterman
Adage Capital Management, L.P.

Great. And then, and switching to the auto side, it seems like there's some concern about rising loss cost trends in the industry. I know you addressed it a little bit earlier. But just within the context of you also as you talked about raising prices, commensurately, do you feel comfortable that the pricing you put through year-to-date has incorporated the loss trend we've seen so far, or are we seeing a little bit of surprise and maybe, we might be behind the curve for a little bit and we have to keep filing for more rate?

Matthew E. Winter
President and President of Allstate Insurance Company

Thanks for the question, Ian, it's Matt. No, we feel comfortable that the rates that we've put in place have reflected the trends as they emerge. Obviously, we don't know what trends are going to emerge tomorrow and next month and if they are outside of the bounds, we'll reflect those in the next set of rate taking or underwriting actions. But again, we haven't been that surprised. BI and PD severities have performed within expectations for the quarter. BI moved with the medical CPI as we would have expected. We did get -- there's been a lot of I guess conflicting information out there about used car prices, ManheimIndex shows a decrease in second quarter after rising first quarter. I know one of the analysts posted something about the CarMax index. So there's a lot of variation and there's things that are transitioning but we feel good about our rates that we've taken. Obviously, some geographies, some states are more challenged in taking appropriate rate and it's harder for us there. And others, we have more flexibility and the ability to accurately reflect what's happening but our goal is, and I would say this not only for auto but for homeowners and in response to your first question, we're trying to charge the right rate. It's all about charging appropriately for the risk we're taking and earning an appropriate margin and providing the customer with a fair value and so we'll continue to try to move with that philosophy.

Ian Gutterman
Adage Capital Management, L.P.

And competitively, are you seeing any signs that maybe your close rates are just trying to go up or anything that suggests -- it does seem a lot of your competitors are sort of struggling with this change in loss trend and maybe have to change their appetite. Has that sort of translate through realtime yet, or not so?

Thomas J. Wilson
Chairman & CEO

We've seen some fluctuation in certain states but I would say it's too early before I could comment on it and tell you I see something that's material and sustainable.

Operator

Our next question is from Alan Straus of Schroders.

Alan Straus

I was just curious what the weather looked like for July, if you guys have any comments?

Thomas J. Wilson
Chairman & CEO

No.

Matthew E. Winter
President and President of Allstate Insurance Company

We'll do what we always do which is if cat losses are over $150 million, I think it's the third Thursday after the close of the month, we'd put a number out. I think we'll just close in the month right now, so I don't have anything to add to that.

Alan Straus

Just ask a second question, given the capital management earnings are a little bit ahead of schedule, would you expect to go to your board a little sooner than you're expected to for -- to re-up the buy back?

Thomas J. Wilson
Chairman & CEO

Well, I think Steve mentioned that traditionally, it was a good addition to the answer that I gave on. In the long term, we believe in giving money back to shareholders. We do it sort of annually. We do try to get ahead of it and then we kind of back off a little bit during hurricane season. We're just headed in -- August, September, October, tend to be the biggest hurricane months. So we probably won't be as aggressive in those 3 months, but yes, as soon as we're done with this one, then we'll, if we have extra capital and the board approves, we'll do another. Yes, I mean -- It's been our -- the amount we bought back, I don't know with the last 15 years, is like over $20 billion. So we believe and if we generate extra capital, then the shareholders should be able to deploy it where they would like to.

Operator

Our next question is from Josh Shanker of Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I can tell from the numbers though, that your auto only PIF growth is up. You said to me you didn't know last quarter. I can tell you, you are growing on auto only PIF and I'm wondering if you can have some color about growth rates going on and then, and where do you think that's headed?

Thomas J. Wilson
Chairman & CEO

Josh, auto only PIF -- or are you talking -- so we have -- we would break it into pieces right? So we have the Esurance piece, which we said is up 13.5% this year. The Allstate brand is down in actual PIF count. Encompass brand is up a little but it's not a -- I think, it's like -- might be $20,000 or something like that. And Canada is up a little. Is there other color other than those component pieces?

Joshua David Shanker
Deutsche Bank AG, Research Division

So, when you say Allstate brand is down, that includes policy that were non renewed with the homeowner as well as policies that were sold as standalone?

Matthew E. Winter
President and President of Allstate Insurance Company

Yes. It will be -- so maybe this will -- if you look at, though -- maybe Matt wants to comment on the growth rate in 3 different categories. So there's Florida and New York, that's one separate auto business. There is -- those homeowner markets where he and his team are hitting it hard to try to get our return back, then there are all other. That might, I think, provide some color for you in terms of helping you analyze where you think that's going to go.

Joshua David Shanker
Deutsche Bank AG, Research Division

I'll take it. [indiscernible] I would like auto only but whatever, go for it. Let's hear the different...

Matthew E. Winter
President and President of Allstate Insurance Company

Well, the good news, Josh is at least we're trying to answer yours. We didn't try to answer Bob's. So let me try to break it down the way Tom suggested. First, New York and Florida obviously, we've -- our auto is -- in both states is, continued to decline. We're focused on margin improvement actions in those states. We're seeing some pockets even within New York, we had a new rating plan put in a few months ago. We're seeing pockets of growth there but when you look at the entire state, you still have a decline. And then as Tom said, if you break down the country and our geographies into those areas where we're taking significant homeowners rate and it's impacting auto growth versus those geographies where we're not taking significant homeowners rate or we're not having significant nonrenewals due to inspections, there is a substantial difference. There's certainly a big correlation between those homeowners actions in certain states and the impact on auto. But it's -- I don't want to overgeneralize and say everywhere that we look at monoline only, we're managing to grow. There are certainly pockets where we are growing and growing nicely. Some of those are due to new rating plans, some of those are due to competitiveness, due to changes from some of our key competitors as one of the earlier speakers asked about. I just -- I would caution you on overgeneralizing anything here. We will have pockets of growth, and as we stabilize the actions we're taking on homeowners, it will free up capacity on the auto side but recall that our target market has historically been multicar homeowners. And so when you take homeowners actions, you're hitting your target market because they bought multiple policies from us. And so, I guess, that's the best I can answer that because I'm not sure. I'm seeing the exact trend you're referring to.

Operator

Our next question is from Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

The first one I think you may have answered this already, but the decline in the homeowners frequency that we're seeing right now, how much of that would you attribute it to underwriting initiatives versus just lower non-cat weather going on so far this year?

Matthew E. Winter
President and President of Allstate Insurance Company

I'm not sure, I can give you a percentage. I'd say it's mixed. It's reinspections, correct class actions, nonrenewals, as well as xCAT weather. So I'm not sure I have the breakdown. Bob do you...

Robert Block

I think it's on a quarter to quarter basis. I would say there's -- when you look at the mix as we talked about prior there some stuff, we got to break down for weather and we may not get a breakdown on that next quarter but...

Matthew E. Winter
President and President of Allstate Insurance Company

No, I mean, fire and xCAT is at a 4-year low. I'm not sure we can expect it to stay at a 4-year low on a long-term basis. And so we've been benefited. If I had to guess, I'd say it's a combination of both factors, maybe 50/50, maybe 60/40 and I couldn't tell you exactly, which is a 60, which is the 40.

Thomas J. Wilson
Chairman & CEO

Well thank you all for participating today. Second quarter, as we said is a strong quarter despite the heavy weather activity. We achieved progress on all 4 of our priorities, and we look forward to talking next quarter. Thanks very much.

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