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Call Participants

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Presentation

Operator

Good day, and thank you for standing by. Welcome to Allstate's Fourth Quarter Investor Call. [Operator Instructions] As a reminder, please be aware that this call is being recorded. And now I'd like to introduce your host for today's program, Mr. Mark Nogal, Head of Investor Relations. Please go ahead, sir.

Mark Nogal
Head of Investor Relations

Thank you, Jonathan. Good morning. Welcome to Allstate's Fourth Quarter 2022 Earnings Conference Call. After prepared remarks, we'll have a question-and-answer session. Yesterday, following the close of the market, we issued our news release and investor supplement and posted related material on our website at allstateinvestors.com. Our management team is here to provide perspective on these results.

As noted on the first slide of the presentation, our discussion will contain non-GAAP measures for which there are reconciliations in the news release and investor supplement and forward-looking statements about Allstate's operations. All these results may differ materially from these statements. So please refer to our 10-K for 2021 and other public documents for information on potential risks. And now I'll turn it over to Tom.

Thomas Joseph Wilson
Chairman of the Board, President & CEO

Well, good morning. Thank you for investing your time in Allstate today. I'll start by setting context, and then Mario and Jesse will provide additional perspective on operating results and the actions being taken to improve auto profitability and increase shareholder value.

So let's begin on Slide 2. So as you know, Allstate's strategy has 2 components: increase personal Property-Liability market share; and expand Protection services, which is shown in the 2 ovals on the left. On the right-hand side, you can see our results for the year. Earnings were disappointing with a net loss of $1.4 billion, largely reflecting an underwriting loss on auto insurance and mark-to-market losses on the equity portfolio. Strong results from homeowners' insurance, protection services and fixed income investments were not enough to offset the losses in auto and commercial insurance.

The most important driver of near-term shareholder value will be successfully executing our comprehensive plan to improve auto profitability. That includes broadly raising auto insurance rates, reducing expenses, including temporary moves such as less advertising and permanent reductions, including digitizing and outsourcing work and lowering distribution costs. Underwriting restrictions have been implemented to reduce new business volume until profitability is acceptable. Claims operating processes are also being modified to manage our loss costs.

This plan is being implemented, but earned premiums from auto insurance rates have not increased enough to offset higher loss costs. And while the #1 priority is to improve auto insurance margins, implementation of the transformative growth strategy has made great progress in 2022, and we validated that this will drive personal profit liability market share growth. Proactive investment risk and return management mitigated approximately $2 billion of losses this year. And while the total return on the portfolio was a negative 4%, that compares very favorably to the performance of the S&P 500 and intermediate bond indices. We also had another great year at Allstate Protection Plan.

Moving to Slide 3, let's discuss financial results. Starting at the top, revenues of $13.6 billion in the fourth quarter were 4.9% higher than the prior year quarter, increasing the full year total to $51.4 billion. Property-Liability premiums earned increased by 9.5% in the fourth quarter compared to the prior year and 8.5% for the full year due to higher average premiums in auto and homeowners insurance.

Moving down the table, an adjusted net loss of $359 million was incurred in the fourth quarter, reflecting an auto insurance underwriting loss, which is impacted by reserve increases for the current and prior years. Now let me turn it over to Mario to discuss our Property-Liability results, and then Jesse will cover the other components of earnings.

Mario Rizzo

Thanks, Tom. Let's start by reviewing underwriting profitability for the Property-Liability business in total on Slide 4. The overall message is that the underwriting loss was a result of auto insurance operating at a combined ratio above our targets, but homeowners insurance continued to be a strong source of profit. On the left chart, the recorded combined ratio of 109.1 in the fourth quarter was primarily driven by higher auto loss costs, unfavorable reserve development and higher catastrophes. This led to a full year recorded combined ratio of 106.6, which was 10.7 points higher than the prior year.

The table on the right shows the combined ratio and underwriting income by line of business for the quarter and the year. Auto insurance had a combined ratio of 112.6 in the quarter and 110.1 for the year, substantially worse than our targets given rapidly increasing loss costs throughout the year. This result was an underwriting loss of $974 million in the quarter and over $3 billion for the year. Hence, you can see why Tom has said executing our auto profit improvement plan is the #1 priority going forward.

Homeowners insurance, on the other hand, had excellent results with the combined ratios in the low 90s, which generated $681 million of underwriting income for the year. This reflects industry-leading underwriting and risk management in this line of business. Commercial insurance was negatively impacted by the same auto insurance cost pressures, along with inadequate pricing for the coverage provided to the large transportation network companies. The result was an underwriting loss for the year of $464 million. This led to the decision discussed last quarter to not provide insurance to transportation network companies unless telematics-based pricing is implemented and to exit 5 states in the Allstate traditional commercial business. These actions are expected to reduce commercial business premiums by over 50% in 2023.

Now let's move to Slide 5 and discuss auto margin in more detail. As you can see from the chart on the left, which shows the auto insurance combined ratio and underlying combined ratio from 2017 through the current year, we have a long history of sustained profitability in auto insurance due to pricing sophistication, underwriting and claims expertise and expense management. In 2020, the combined ratio dropped to 86 even though we provided customers with over $1 billion of shelter-in-place payments. This was due to historically low accident frequency in the early stages of the pandemic. In 2021, frequency increased as mileage driven increased, but it did not reach pre-pandemic levels. Claims severity, however, increased above historical levels because of more severe increasing costs to settle claims with third parties who are injured in accidents with our customers.

In addition, used car prices were increasing at unprecedented levels, eventually peaking in December, reflecting an approximate 50% increase over the prior year. We had a reported combined ratio of 95 for the year despite all these pressures. This year, the combined ratio increased 14.7 points to 110.1, the drivers of which are shown in the right-hand chart. The red bars reflect the impact of increasing loss costs, including a 3.6 point impact from prior year reserve additions and a 16.7 point impact from current year underlying losses, excluding catastrophes, which include increases in both frequency and more significantly, severity compared to last year.

As we discussed, the core component of the profit improvement plan is to raise auto insurance rates and substantial progress was made on this front starting in the fourth quarter of 2021 and throughout last year. In 2022, the impact of higher average earned premium drove a benefit of 3.6 points, which is shown in green. As I will cover in a minute, there is much more benefit to be realized in earned premiums based on what was implemented in 2022. Another part of the profit improvement plan is to reduce expenses and this contributed a favorable 2 point benefit this year.

Moving to Slide 6, let's discuss prior year reserve reestimates before we look forward. Our loss estimates and reserve liabilities use consistent practices, multiple analytical methods and 2 external actuarial reviews to ensure reserve adequacy. These processes led us to increase the reserve liability for prior years throughout 2022 by amounts that are larger than recent years. Property-Liability prior year reserve strengthening, excluding catastrophes, totaled $1.7 billion or 3.9 points on the combined ratio for the full year 2022. The pie chart on the left breaks down the impact by line and coverage, with $1.1 billion driven by Allstate brand personal auto, largely related to bodily injury claims.

In addition, $295 million was related to Allstate Brand commercial insurance, also mostly related to auto. The table on the right breaks down the Allstate brand auto prior year reserve strengthening of $1.1 billion in 2022 by report year. Let me orient you to the table. Reserve increases are shown by coverage in total and then for the report here to which they apply. The reserve liability for physical damage coverages was increased by $211 million, which was entirely attributable to 2021. This primarily related to adverse development and elongated repair time frames, which were primarily addressed in the first and second quarter.

Injury reserves were the largest component at $676 million, which was spread across many report years. Incurred but not reported was increased by $226 million as late reported claim counts have exceeded prior estimates. This reserve balance was increased in each of the first 3 quarters of 2022, but a larger amount was recorded in the fourth quarter. In total for all coverages, about 63% of the increases were for 2021 and 2020.

At the bottom of the table, the reported combined ratio for the calendar year is shown and compared to the reserve changes. For example in 2021, the reported combined ratios for Allstate brand auto insurance was 95. The reserve additions indicate that costs were 2.1 points above this reported number. Estimating reserve liability utilizes multiple reserving techniques, but is always subject to strengthening or releasing reserves over time. This variability increases with changes in the underlying data, such as claim counts, settlement times, or cost increases and as has been the case over the past 3 years. While reserves could change going forward, based on the 2022 claim statistics and data, reserves are appropriately established at year-end 2022.

Moving to Slide 7, let's provide some clarity on what the auto insurance combined ratio trend was by quarter in 2022. As you can see on the left-hand chart, the recorded combined ratio peaked in the third quarter at 117.4, largely reflecting prior year reserve changes and catastrophe losses shown in light blue. The dark blue bars are the underlying combined ratio, as reported, which increased each quarter. Included in this dark blue bar is the impact of increasing claim severities within the year. We update the forecast on claim severities as the year progresses.

As 2022 developed, loss cost trends resulted in increases to current report year ultimate severity expectations. As shown in the call out on the left chart, 2022 incurred severities for collision, property damage and bodily injury was 17%, 21% and 14%, respectively, above the full report year of 2021 level. This estimate, however, increased throughout the year. The impact of increasing current report year on incurred severities as the year progressed influences the quarter underlying combined ratio trend. This impact from increasing full year severities from claims occurring in prior quarters is reflected in the financial results of the period where severities were increased. For example, the fourth quarter of 2022 reflects the impact of higher severity expectations in the auto physical damage coverage, not just for claims reported in Q4 but also for claims that were reported throughout the prior 3 quarters as well.

The chart on the right adjusts the quarterly underlying combined ratio to reflect full year average severity levels, which removes the influence of intra-year severity changes. As you can see, after adjusting for the timing of severity increases in the current year, the quarterly underlying combined ratio trend was essentially flat throughout 2022 and close to the full year level of 103.6.

Slide 8 outlines our comprehensive approach to restore auto margins. There are 4 areas of focus: raising rates; a continued focus on reducing expenses; implementing stricter underwriting requirements; and modifying claim practices to manage loss costs.

Starting with rates. Since the beginning of this year, we've implemented rate increases of 16.9% in the Allstate brand, including 6.1% in the fourth quarter, which significantly increased written premium. We expect to continue to pursue significant rate increases into 2023 to improve auto insurance margins to target levels. We are also reducing operating expenses as part of transformative growth and have temporarily reduced advertising spend to manage new business volume.

We are implementing more restrictive underwriting actions on new business in locations or risk segments where we cannot achieve adequate prices for the risk. Increased restrictions have been implemented in 37 states including California, New York and New Jersey, which account for a large portion of underwriting -- of underwriting losses. Claim practices have been modified to deal with the higher loss cost environment. For example, we have strategic partnerships with part suppliers and repair facilities to mitigate the cost of repair and use predictive modeling to optimize repair versus total loss decisions and likelihood of injury and attorney representation.

Moving to Slide 9, let's discuss a key component of our multifaceted plan raising auto insurance prices. Growth in average premium per policy is accelerating due to implemented rate increases, but the impact to average earned premium per policy is on a lag due to the 6-month policy term. The chart on the left depicts the year-over-year growth in auto average gross written premium in orange, reaching 14.4% in the fourth quarter of 2022. The auto average earned premium growth of 9.7% in the fourth quarter, represented in blue, continues to increase, but on a lag due to the 6-month policy term. The chart on the right is an estimation of when the rate increase is implemented will be earned into premiums. Of course, actual earned premium growth will be influenced by changes in the number of policies in force and absolute levels of new business and retention.

This illustrative example assumes 85% of the annualized written premium will be earned since customers modify policy terms such as deductibles or limits where they may not renew. Starting on the left, over the last 15 months, we've implemented Allstate brand auto rate increases of 19.8% for an estimated annualized written premium impact of approximately $4.8 billion. Using the historical 85% effectiveness assumption nets a total of $4.1 billion in expected earned premium, represented by the second blue bar. Approximately $1.2 billion has been earned through the fourth quarter. Of the remaining $2.9 billion of premium yet to be earned, roughly $2.6 billion will be earned in 2023 and $300 million in 2024 as shown in green. As I mentioned earlier, we expect to implement additional rate increases in 2023, which will be additive to the figures shown on this chart.

Slide 10 illustrates the drivers that will determine the timing of improved auto profitability. The chart on this page is an illustrative view we've shown in the past on our path to target profitability along with the magnitude of actions already taken and required prospectively. Starting on the left, the first blue bar shows the year-end 2022 auto insurance reported combined ratio 110.1. To start with the normalized base, we removed the impact of prior year reserve increases and normalized the catastrophe loss ratio for our 5-year historical average. This improves the combined ratio by roughly 4.5 points.

The second green bar reflects the estimated impact of rate actions already implemented when fully earned into premium, which we discussed on the prior slide. The impact on the combined ratio is approximately 10.5 points when combining the Allstate brand and the National General brand actions. Those 2 adjustments would improve the combined ratio to target levels. Now of course, we know that loss costs will increase, whether from severity or accident frequency, which would increase the combined ratio. So prospective rate increases and other margin improvement actions must meet or exceed loss cost increases to achieve historical returns. We continue to manage the auto insurance business with the expectation to achieve an auto insurance combined ratio target in the mid-90s.

Moving to Slide 11, the table shows Allstate brand model results in 3 major states: California, New York and New Jersey combined contributed approximately 1/4 of the Allstate brand auto written premiums in 2022 but accounted for approximately 45% of the underwriting loss. While rates were increased in 2022 by 7% to 10%, this is not enough to achieve target margins. As a result, we have more work to do, some of which is listed on the right-hand side.

The right-hand side of the slide is a list of actions we are taking in each of these states to improve margins. In California, we filed for an additional 6.9% rate increase in January after getting approval for an initial 6.9% rate increase and are significantly increasing down payment requirements. In New York, while multiple rate filings were requested, only partial approval of the increases requires us to make additional rate filings in early 2023. Increased down payment requirements, allowable prior incidents and channel restrictions means fewer choices for consumers until an adequate rate is approved. In New Jersey, additional rate filings will also be made and similar underwriting actions will be implemented as those taken in New York.

Moving to Slide 12. Let's look at a continued good performance story in homeowners insurance. As you know, a significant portion of our customers bundle home and auto insurance, which improves retention and the overall economics of both product lines. We have a differentiated homeowners product, underwriting, reinsurance and claims ecosystem that is unique in the industry. Net written premium has increased significantly throughout 2021 and into 2022, increasing 9.3% from the prior year quarter and 12% for the full year, predominantly driven by higher average gross written premium per policy and a 1.4% increase in policies in force. National general written premiums also increased as we improved underwriting margins closer to targeted levels.

The fourth quarter combined ratio for homeowners of 92.6 increased by 5.5 points compared to the prior year quarter, while full year combined ratio of 93.8 and declined by 3 points compared to 2021. For the year, this line generated $681 million of underwriting income. The increase in the fourth quarter is shown on the right side. The increased combined ratio was driven by elevated catastrophe losses, primarily due to winter storm Elliot. Homeowners insurance was also impacted by the higher loss cost environment as we continue to experience higher severities due to increasing labor and material costs. To address the inflationary environment, our products have sophisticated pricing features that respond to changes in home replacement values.

And now I'll turn it over to Jesse to discuss the remainder of our results.

Jesse Edward Merten
Executive VP & CFO

All right. Thank you, Mario. While Property-Liability is a core business for us, there are other important drivers of financial performance to discuss, starting with investment income on Slide 13. As shown in the table at the bottom left, the total return of our portfolio was 2.5% in the fourth quarter and negative 4% for the year. These returns for our broadly diversified portfolio compare favorably to the full year performance for the S&P 500 of negative 18% and to the Bloomberg Intermediate Bond Index return of negative 9%.

Net investment income, shown in the chart on the left, totaled $557 million in the quarter, which is $290 million below fourth quarter of last year. Market-based income of $464 million, which is shown in blue, was $101 million above the prior year quarter. This is the third consecutive quarter of increase as we benefit from reinvestment at higher market yields.

Performance-based income of $147 million shown in black, was $369 million below a strong prior year quarter. Income this quarter included a negative contribution from valuation of private equity fund investments that was more than offset by positive contributions from direct investments, along with positive returns for infrastructure and real estate. The chart on the right shows the fixed income yield is rising and was 3.2% at quarter end, but is still below the current intermediate corporate bond yield of 5.3%. Also shown is that duration increased modestly to 3.4% in the fourth quarter, primarily by removing approximately half of our duration shortening interest rate derivatives.

The migration of the portfolio to higher yields and the corresponding increase in income will happen over time as we reinvest portfolio cash flows into higher interest rates. With the portfolio and an unrealized loss position, accelerating this shift by selling bonds to generate capital losses, but will be pursued if it optimizes enterprise risk and return.

Now let's turn to Slide 14 and talk more about how enterprise risk and return management impacts investment allocations and results. Proactive investment management is highly integrated with risk-adjusted return opportunities across the enterprise. We discussed this in detail on our September 1 special topic call on investments. In 2021, we decided to lower overall risk levels given the declines in auto insurance profitability. We also expected that sustained inflation would lead to higher interest rates. As a result, the economic capital deployed to investments was reduced. This led to a shortening of the bond portfolio through the sale of long corporate and municipal bonds and the use of derivatives. While adverse market conditions negatively impacted our portfolio, these actions mitigated losses by approximately $2 billion.

In 2022, given continued auto insurance losses, we decided to lower the potential for investment losses as the U.S. economy went into a recession. At the same time, interest rates were increasing offering a better risk-adjusted return from fixed income. Consequently, holdings in below investment-grade bonds were cut almost in half, and public equity holdings were lowered by 40%. Later in the year, interest rates had increased and the duration of the bond portfolio was extended, as shown on the previous slide. About half the duration shortening derivative position was removed in the fourth quarter. At the same time, this lowered the amount of economic capital deployed to investments. These actions optimized enterprise risk and return and provide flexibility to take advantage of investment opportunities as economic conditions evolve.

The Protection Services business businesses also create shareholder value, as shown on Slide 15. Revenues, excluding the impact of net gains and losses on investments and derivatives, increased 6.1% to $643 million in the quarter and 8.7% to $2.5 billion for the full year 2022. The increase in revenue for the fourth quarter and full year was primarily driven by Allstate Protection Plan's growth of 16.9% and 15.7%, respectively. As you can see from the table on the right, Allstate Protection Plans continues to rapidly expand with written premium of $1.9 billion for the year.

Allstate Protection Plan's expansion in 2022 is primarily driven by our investment in appliance and furniture product coverages. We continue to believe there is a significant growth opportunity in these areas and in our continued expansion of European consumer electronics and other international growth. Given the longer policy term compared to auto and homeowners insurance products, the unearned premium balance continues to significantly grow as well, reaching $2.6 billion at the end of the year. For the segment, adjusted net income of $38 million in the quarter increased $9 million compared to the prior year due to a onetime net tax benefit in Allstate Protection Plans. Full year adjusted net income of $169 million decreased $10 million compared to the prior year primarily due to the lower revenue in Arity as a result of decreased insurer client advertising. We will continue to invest in growing these businesses as they provide an attractive opportunity to meet customers' needs and create economic value for our shareholders.

Moving on to Slide 16. Allstate Health and Benefits is growing an attractive set of businesses that protects more than 4 million policyholders. The acquisition of National General in 2021 added both group and individual products to our portfolio, as you can see on the left. Revenues of $579 million in the fourth quarter of '22, excluding the impact of net gains and losses on investments and derivatives, decreased 1.5% to the prior year quarter as a reduction in individual health was partially offset by an increase in group health and other revenue. Adjusted net income of $50 million increased $2 million compared to the prior year quarter, resulting in a full year 2022 income of $222 million. The full year 2022 result was $14 million above prior year and reflects increases in group health revenues, partially offset by higher operating costs and expenses and group health contract benefits.

Let's close by highlighting Allstate's strong financial condition and proactive approach to capital management, which you can see on Slide 17. We ended the year with $4 billion in holding company assets, which represents an increase of $700 million compared to year-end 2021. We believe holding company assets and capital resources available from statutory operating companies provide financial flexibility as we continue to implement profit improvement actions, invest in transformative growth and return capital to shareholders. As you can see, our adjusted net loss in 2022 resulted in a negative adjusted net income return on equity. Executing our comprehensive plan and achieving target combined ratios for auto and homeowners insurance will bring adjusted net income returns on equity back to our long-term target range of 14% to 17%.

In 2022, we returned $3.4 billion to shareholders through $2.5 billion in share repurchases and $926 million in common shareholder dividends. This resulted in common shares outstanding being reduced by 6.1%, reflecting the repurchase of 19.7 million shares in 2022.
With that as context, let's open the line for your questions.

Question and Answer

Operator

[Operator Instructions] And our first question comes from the line of Paul Newsome from Piper Sandler.

Jon Paul Newsome
Piper Sandler & Co., Research Division

I wanted to ask about claims management process that over the course of the last couple of years. I think of Allstate is having a superior claims management in auto and home, and that being kind of one of the core advantages. But you've also been implementing a lot of cost cuts and laying off folks over the last couple of years. So how are you, sort of, balancing that? And are there some core metrics that we can see as outsiders that suggest that, that advantage relative to your peers still exists?

Thomas Joseph Wilson
Chairman of the Board, President & CEO

Thank you, Paul. Let me make a few overview comments, and then Mario can jump in. You're correct that one of our competitive advantage is really really claiming that both effectively and efficiently settling what are millions of claims a year. And we really look at like it's a systems approach. It's not the result of 1 person process or vendor arrangement.

But like, for example, if you look at auto insurance, we have this network of auto body repair facilities enables us to both source high-quality costs, high-quality repairs, good costs and timely stuff. So it's cutting down things like rental use and stuff like that. At the same time, we have extensive use of analytics, whether that's the value of an individual car in a local market with specific options, to settlements of complicated multiyear bodily injury claims or fraud detection.

Part sourcing and buying that Mario talked about enables us to both control the price of those parts by buying them in bulk. But also deciding which parts to use, use an OE part or an aftermarket part, what's available in the local market. So the reason I'm going through that is it's a really complicated system that works really well. We've got good employee training, got good technology. We have good quality control processes.

And we do have metrics that you can look at to determine how we're doing versus the outside. There's first call reporting and there's some other external reporting, which shows, for example, that we have -- we buy -- we pay less per claim for parts and labor than other people. So some of that information, like first call, you guys could have access to. Others we get from other sources.

But what it tells us is that we're good. Now anytime you're good, the only reason -- the only way you stay good is you keep changing and getting better and updating processes. And so as we've dealt with these dramatic swings in frequency and cost, we continue to implement changes to improve the effectiveness and efficiency, and Mario can talk about those.

Are we perfect? No. Are we constantly reassessing everything we do to make sure we're getting the right price for parts and we're settling it at the right value for customers? Of course. Do we believe it's still a continued competitive advantage for Allstate? Yes. So Mario, would you want to talk about some of the things you worked on last year and what you are looking for this year.

Mario Rizzo

Thanks, Tom, and thanks for the question, Paul. First thing I would reiterate what Tom said. We continue to view our claims capabilities as a competitive differentiator and a source of real value for Allstate. We think that's been certainly been true in the past and it'll continue to be true going forward.

The reality is, given the environment we're operating in, both from a from a casualty perspective as well as physical damage, we've talked a lot throughout the year around the drivers of inflation and the things that are driving up loss costs at such a rapid pace. And I think what that does is it really forces us and the industry to continue to evolve those practices. And it's certainly something we've done over time to continue to maintain our leadership position and our edge when it comes to claims.

So let me just spend a minute and I'll break out casualty versus physical damage in terms of the action plans we talked a lot about changing operational processes. I'll say a couple of things starting with casualty. First, one of the things we've done over the past 12-plus months is we've meaningfully reduced the volume of pending bodily injury claims by about 20%. And what that does is it reduces risk of both of inflation impacting those claims that certainly that we've settled and remediated going forward, but also reduces, we think, reserve uncertainty on those claims going forward.

And to just give you a sense of context, the current level of bodily injury pending claims in aggregate is at its lowest level that it's been since before 2016. So we've looked to de-risk the bodily injury pending portfolio by leaning in and settling claims. We're also focusing on a strategy that I would characterize as an earlier strategy when it comes to bodily injury. Things like earlier recognition of injury claims, earlier claimant contact and earlier settlement of claims that we should settle quickly, again, to avoid the inflationary risk in the current environment.

And what we're doing is we're leveraging our advanced data and analytics capabilities to execute on all components of that strategy, to continue to evolve and get better in casualty claim handling. On the physical damage side, I think it's really around broadly continuing to focus on estimation accuracy, cycle time and leveraging -- further leveraging our scale to the full extent. It's continuing to increase the utilization of our good hands repair network to reduce costs, both in terms of parts and labor costs and improved cycle time, while continuing to improve or provide a high-quality customer experience. Enhancing total loss processes to reduce cycle time and reduce costs around things like storage and rental costs. And identification of preexisting damage on vehicles, again, to move total losses through the system more rapidly. And then continuing to look to leverage our scale additionally when it comes to sourcing parts and getting as efficient as we can from a process perspective.

So we're really attacking claims across a number of fronts again, I feel really good about where we're positioned with claims. And this is all about continuing to get better and maintain that industry-leading capability on the claims side.

Jon Paul Newsome
Piper Sandler & Co., Research Division

Is there any difference in how you handle claims across the distribution systems at this point that would vary the execution of claims?

Mario Rizzo

This is Mario. I'll jump in. Process-wise, we adopt consistent processes across claims. There are certainly unique processes, for example, in National General given the nonstandard auto mix. There's just a different approach to those claims because they potentially have a higher risk of fraud. So there's some unique processes there. But in terms of claim handling consistency, for similar types of claims, we tend to leverage best practices across brands.

Operator

And our next question comes from the line of Gregory Peters from Raymond James.

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

Tough quarter and a tough year for the company. I was looking at Slide 11 in the supplement. And this is the slide that talks about the Allstate brand auto state profitability. And if we look at the number of states that have a combined ratio above 100, it steadily increased through the fourth quarter.

And it kind of -- contrary to the comments you made about the rate that you applied and achieved in the year. So my question is, what type of expectation do you have for that category of states above 100 as we move through '23? Is it kind of peak here at [41]? Do you think it could get worse? Or what's your expectation going forward of how that might trend?

Thomas Joseph Wilson
Chairman of the Board, President & CEO

Greg, let me provide an overview, then Mario can jump in on it. As we said and you know well that improving auto profitability will be a key to driving shareholder value. So we're all over that. We've made a lot of progress. Mario showed about the rate increases. And so of the $4.1 billion that we think will still come true, or that will come through from the rate increases we've already implemented, we've got $1.2 billion, $2.6 billion of that should show up in 2023.

And I would point out that, that's not in those combined ratio numbers. So our objective is to make money in every line in every state. So no cross subsidies between states, no cross-subsidies between lines. Now of course, that's hard to do with as many lines as many states we're in, but that's our objective. And so the amount -- that amount that's not reflected in the -- some of those states.

We think some of those states are probably adequately priced today. There are many that are not, and so we'll continue to drive those. But I would expect to see that number come down. But we don't have a target of -- we're at 41 at the end of the year. We want to be at some XX at the end of the first quarter. It's every state, every line, make money every year. Mario, would you want to add some additional color to that?

Mario Rizzo

Sure. And thanks for the question, Greg. Look, I think when you look at that trend of states above 100 and the increase throughout the year, I think what I'd point you to is when you just -- you look at our underlying auto combined ratio as we reported it, increasing throughout the year and being driven by increases in our severity expectations quarter-over-quarter as the year played out, as well as increasing frequency between Q1 through Q4, only partially being offset by the rate that we took.

So I think that chart mirrors what we show you in aggregate in terms of the reported underlying combined ratio. But when you look at our business from a state perspective, I think it's important to really categorize states into a couple of different buckets. I think there's a group of states that while we certainly are pleased with the outcome of an underwriting loss -- given the actions we've taken, particularly from a rate perspective as well as underwriting actions, we feel like we're positioned in a good place.

Now you can't predict the future in terms of the path of inflation or severity going forward. But given the actions we've taken, we feel good about where we're positioned and what the outlook looks like for 2023. I put states like Texas, Georgia, a couple of large states for us where we've implemented significant rates and have been successful in doing so. And so we feel good about the outlook.

Again, we'll have to adapt to what changes in the future, but I think there's a lot of states that falls into that category. Unfortunately, there's a number of, for us, pretty meaningful states, 3 of which we highlighted in the presentation: California, New York, New Jersey, where they're much more challenging regulatory environments. And we need to continue to execute on both rate increases and underwriting restrictions to curve growth, to really bend the line in aggregate.

And just using California as one example. So as you all know, we got a 6.9% rate approved late in the year, but we immediately filed another 6.9% increase pending with the department. We took down paid requirements up pretty dramatically. We have not changed those down paid requirements even with the first rate. We're working with the department on getting approval for the second 6.9%.

But then we're going to come back with another rate increase because we need more rate in California. So that's a big state for us where we're going to have to continue to really lean in and take -- continue to take dramatic and aggressive actions to improve margins.

And I put New York in that same category. We got a 5% flex rate in New York. Middle of the year, we got approval for a 9.4% rate in New York towards the end of the year, while we're prepared to do additional --

an additional round of rate filings in New York early in 2023, because loss trends are not where they need to be.

And in the interim, we've taken underwriting actions around prior incidents, down pay and other actions to curb new business growth, and we're going to continue to lean into those actions because we can't afford the right new business at the current rate levels. And we'll continue to take the appropriate actions there.

So I think you got to look at the states in a different way. I think we've made a lot of progress in a number of states, but we still have some work to do. And as we said, we expect to take some pretty significant rate increases in 2023, particularly leaning into some of those states where we haven't, really for regulatory reasons, been able to make the kind of progress that we would have liked.

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

That's good detail. Just the follow-up question on those 3 states, California, New York and New Jersey. And I know you're not going to start negotiating with the Departments of Insurance on an earnings conference call. But when I look at California, for example, you yourself said 6.9% is not going to be enough.

One of your competitors recently got just last month got a rate increase improved that was in the teens. Why not pivot and get more aggressive with rate filings in some of these challenging states? It seems like some of your peers might be doing that and getting -- having some success.

Thomas Joseph Wilson
Chairman of the Board, President & CEO

Greg, I would just maybe provide -- I think we've been very aggressive when you look at how much we've raised rates in total for the year across the country. We've been very aggressive. And depending whose measures you want to use, more aggressive. As you never really know where people start and what they finish and what their losses there. Mario, do you want to talk specifically about California?

Mario Rizzo

Yes. Sure. So Greg, I think we've been working really closely with the Department of Insurance in California. We were able to rapidly get approval of our first 6.9%, and we're in active dialogue around the second 6.9%. And as I mentioned, when we get that one behind us, there'll be a third one coming.

We always have the option of going down the path of filing a larger rate increase. California generally takes a longer time period to get approvals for rates as it is. And the one you mentioned specifically, I think, have been pending with the Department for over a year. So we're -- as we look at the map, we want to get approval, we want to get approval as rapidly as we can, so we can implement the rates and move on.

So the approach we've taken so far in California, we're comfortable with. We're going to continue to lean in. We always have the option to change course if things change. But so far, we've had success with the path we've taken, and we're going to continue to push on that.

Operator

And our next question comes from Elyse Greenspan from Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question is just on capital, right? You guys said you expect to complete the buyback program by the -- still by the end of the third quarter of '23. Can you just help us understand what metrics you're looking at to judge the capital adequacy of Allstate Insurance company at the end of '22? I think in the past, you've said you look at RBC ratios there. Can you give us a sense of where you ended '22 your RBC was, and where you would like that to be over time?

Thomas Joseph Wilson

Chairman of the Board, President & CEO

Elyse, I'll let Jesse give you some specifics, but we obviously have a long history of managing capital that both balances our financial strength, growth and returns to shareholders. We have plenty of capital to grow our business and pursue attractive risk and return opportunities.

We do it in a much more sophisticated way than RBC. So for example, when Jesse talked about the things we had done in the investment portfolio, that we allocate specific amounts of capital to different investment allocations. So when we dial up interest rate risk, we put a little more capital up for it. If we dial down equities, we put up less capital, and we believe we're really well capitalized and don't have any issues. Jesse, do you want to go from there?

Jesse Edward Merten
Executive VP & CFO

Yes. Thanks, Tom. So Elyse, I think as it relates to your question on RBC, we haven't disclosed the RBC for the year. That will come out in due course as it relates to the actual RBC in insurance company, and we don't publish a target.

I think Tom hit on the right point, because you asked what are the metrics that we look at as we think about the repurchases. And we really do focus on our sophisticated economic capital model that looks at a comprehensive view of risk across types around the enterprise. And we use that as the basis for capital management. We obviously focused on RBC rating agency metrics, a variety of other things. But we don't have specific targets that we published as it relates to risk-based capital.

So -- and I really like to take it up a level and just think about how we manage it overall using our sophisticated, risk-based capital framework. We remain confident in our overall capital position and the capital position of the insurance subsidiaries.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And then my second question is going back to some of what you guys have been discussing with modifying your claims practices. Have you guys tested the predictive modeling on an external data against your own internal data and seeing a meaningful benefit? And should we -- how -- over what time period should we think about the rollout of the program over the next year, 12 to 24 months, on what type of time frame should we be thinking about?

Thomas Joseph Wilson
Chairman of the Board, President & CEO

Elyse, I'm not sure which predictive models -- are you talking about the -- I mean we use predictive models for a lot in claims. Was there one specifically you were interested in? .

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Well, I was talking about some of the kind of changes you guys have stressed that you're kind of looking to make on the claims side of things.

Thomas Joseph Wilson
Chairman of the Board, President & CEO

Okay. Yes. Let me -- I'll take a shot at it and Mario, you can jump in. So we use -- I mean we're a data-driven company, so we use predictive models as you know well, for just about everything. That could be fraud. There could be -- do we think this claim might end up being severe enough where it gets represented by a lawyer?

So it's important for us to establish a relationship with the customers as possible. It might be, do we think there's a better way to settle this claim, whether it gets -- the car gets totaled or we send it to a body shop. So there's -- we use predictive analytics throughout the business and obviously -- largely in claims as well.

So we're always tuning those. We think we're pretty good at it. You can't really take one specific algorithm. But when you look at our claims severities, you can look at them externally. And when you look at absolute dollars, we think we did really well. It's easier on physical damage, obviously, because you're just fixing a car. Bodily injury, it's like, okay, well, what was the case worth? What's the average case? That gets a little harder to do.

But when in -- the only weakness in the external stuff, is it tends to be a percentage increase over the prior year, which is, of course, we work in absolute dollars. And our models are done in absolute dollars. And so even though it all depends on where you start -- but we like our overall position. Mario, do you want to talk specifically about any models that you're using now that think you can point to where we've updated and increased the value added?

Mario Rizzo

Yes. The one I'd point to, and I think generally, the statement Tom made about like leveraging all the data and the capabilities we have, but also looking to tune those models and evolve over time. The example I would use would be around bodily injury, both potential loss identification and attorney representation.

Given, obviously, the environment around us has evolved pretty significantly over the past couple of years in terms of higher levels of attorney representation and bodily injury claims and just medical inflation, medical consumption and treatment, those kinds of things. So what we've been doing is tuning the models to -- to be able to use the components and the data that we gather early on in the claims process, to identify claims where there is, first of all, the potential for an injury. More importantly, the potential for a major injury given it's a higher impact accident or things like that. So we can get out ahead of the claim, make contact earlier and manage the claim much more effectively.

The same would be true around claims that have the potential, ultimately, to be represented by an attorney. Again, creating contact with a third-party claimant and establishing dialogue and communication and leveraging the tools and the models at our disposal to better manage the claim process through the bodily injury claims. So those are just a couple of examples of how we tuned models that we've had to adapt to the current environment.

And we're going to have to continue to, as I mentioned earlier, evolve our processes and those models to adapt to the environment over time. So this is not a static process, and we're always looking to get better based on the most current information as well as the external environment that we're operating in.

Operator

And our next question comes from the line of Andrew Kligerman from Credit Suisse.

Andrew Kligerman

First question is around social inflation, and in particular, bad [price point]. And in 2022, [indiscernible] the court up a lot. And we -- I would -- I suspect that had a big impact. As we move into 2023, what's your thinking about further social inflation issues? Do you think it will get materially worse? Could you give us some measurement around that? And that's the question. .

Thomas Joseph Wilson
Chairman of the Board, President & CEO

Mario, do you want to take that?

Mario Rizzo

Yes. Certainly, social inflation is a phenomenon that we and the industry have been dealing with for an extended period of time. I think in our business, we certainly see it in the personal auto side, in casualty coverages. We've also seen it on commercial auto and in the shared economy, just given the higher limits that we tend to write on that business.

It's hard for me to predict whether it will get better or get worse going forward. I think it's a reality of what we're experiencing right now. And as I talked about some of the analytics and the processes we're putting in place, to identify and manage injury claims more effectively. That's a big reason why we're doing it is in response to the social inflationary impacts we've seen.

I'd also go back to something I said earlier around quickly not only identifying but settling claims earlier in the process where we can to mitigate the potential exposure to social inflation going forward. And the reduction in pending claims across a variety of segments that we've already executed on and are going to continue to focus on going forward.

So I think our approach has been to modify our processes and take appropriate actions to offset the impacts of social inflation. And again, I don't want to predict whether it will get better or get worse, but we know it's a reality and we've adapted in response to it.

Andrew Kligerman

Was there a big pickup in bad faith claims?

Mario Rizzo

I wouldn't say there's a big pickup in bad faith claims now. .

Andrew Kligerman

Okay. And then the next question is around the rate increase. So I think Greg was touching on how your competitor got in the teens. I think it was 17.4% and you got 6.9%. My question there is should we worry that there will be anti-selection? If other players are getting these big rate increases, will that drive more consumers to Allstate as the pricing appears better in California?

Thomas Joseph Wilson
Chairman of the Board, President & CEO

Mario, do you want to take that?

Mario Rizzo

Yes. Look, as I mentioned earlier, even with the rate that we were approved for -- we didn't change the actions we took around down pay requirements. So our risk appetite is not -- has not changed in California, and it won't until we get to a point where we believe we're adequately priced, and that will take at least a couple more rates.

Will we get anti-selected against? I think if we keep the restrictions in place or down pay requirements in place, we mitigate that risk. And it's all relative. The rate increase that was approved was on a much larger indication than the one we filed. So it's hard to tell what the relative price position is.

But again, we're not going to change our stance. Our focus in California is to reduce growth as much as we can until we get to rate-adequate levels, and that's the way we're going to manage the business.

Operator

And our next question comes from the line of Josh Shanker from Bank of America.

Joshua David Shanker
BofA Securities, Research Division

I was looking at the new policy application, and I was trying to tease out Allstate, National General and agency versus exclusive agency versus direct. And I noticed that there was a nonsignificant amount of independent agency, new policy applications coming from non-National General sources.

And so I'm wondering, is Allstate brand being sold through independent agencies? And the reason why I asked this is also I noticed that new policy applications from Allstate exclusive agents are up, but Allstate branded new policy applications are down overall. Meaning that it feels like there's a channel shift that you're excited about getting business from Allstate exclusive agents, but not from the other sources where you sold Allstate branded products last year.

Thomas Joseph Wilson
Chairman of the Board, President & CEO

Let me provide a little overview. And then Mario you can take it. So Josh, first, we'll take business from anybody's, not just for price. You are correct in that you see -- remember, National General, we took -- when we acquired National General, we gave them both the Encompass business, which was straight up independent agents under the Encompass brand. There's also an Allstate independent agent channel that we're transitioning to National General products and services over time. So the National General has both of those.

On the direct versus agent piece, we've been shutting down growth and reducing expenses. We went first to the direct channel because it was faster, and we got more dollars out of it. That doesn't mean that we have a preference for Allstate agent versus direct. We'll serve customers any way they want to be served. Mario, do you want to add some additional perspective on that?

Mario Rizzo

Yes. And maybe I'll focus on -- first on the Allstate brand, Josh, in terms of the shift, the mix shift between direct and exclusive agents. So you'll remember a couple of things. One of the things we did this year was we reduced the amount of advertising spend, particularly lower funnel advertising spend, which directly impacts both volume through the direct channel. And I think you've seen a decline in the direct Allstate branded production as a result of that.

I think the other thing you've seen is the phenomenon we're experiencing in the exclusive agent channel with Allstate. And I'll take you back to one of the core tenets of transformative growth was to reduce costs. But one of the components of it was to reduce distribution costs by changing how we compensated our exclusive agents, and also introducing lower cost, higher productive new models.

And I think what you see in 2022 is that the model that we put in, that shifts agency compensation more to new customer acquisition has driven a level of engagement and behavior change on behalf of our exclusive agents that's resulted in an increase in new business production, despite the rate actions that we've taken. I think as we go forward, we're going to continue to evolve the agency model. We'll continue to shift commission away from renewal to new business. And while at the same time, continue to enhance our direct capabilities so that when we do lean back into growth, we're willing to accept the grow through any channel that we can write it.

But I don't think it's unreasonable to assume that the first place you'd see kind of sequential growth would be in the direct channel, just given that when we turn advertising back on, that will be where a lot of the claim volume is driven through. But at the same time, we are pleased with the -- again, the engagement and the behavior shift of our exclusive agents and the performance of the new agency models in terms of their levels of productivity, which I think bodes well for us from a long-term growth perspective.

Joshua David Shanker
BofA Securities, Research Division

Is there a difference in profitability over the lifetime of the customer, depending on the brand and the channel it's sourced? And long term, should there be any difference?

Mario Rizzo

Yes, I can jump in. Any Allstate brand, I think over time, it should be the same, right? Because we're targeting and marketing to the same customer segment and looking to drive the same lifetime value, whether we write it in the agency channel or we write it in the direct channel.

And you'll remember, we've gone to differentiated pricing to match the cost of the channel with the price that the consumer is paying. So that kind of normalizes for the acquisition cost or the distribution cost. So we'd be getting the same lifetime value.

I think in the National General brand, what we've got today is predominantly still a nonstandard mix, which has a very different lifetime value than the standard and preferred products that we write in the Allstate brands. But we price for that. We have the fee structure in place for that where -- and we manage that business very effectively to drive value for a much shorter policy life expectancy for those nonstandard risks.

As we roll out more middle market products in National General, we've really started on that process, but we've got a ways to go there. The value -- the lifetime value expectancy for that policy group should look and feel a lot like the Allstate brand because we're leveraging the same data, the same capabilities to expand our capabilities in that market.

So I think from a customer segment perspective, it should be very similar across channels, given the same risk profile. Different in nonstandard auto, but we've got a really effective model in National General to manage that business.

Thomas Joseph Wilson
Chairman of the Board, President & CEO

So thank you all for tuning in. Allstate's obviously focused on using our extensive system operating expertise to improve auto insurance margins. And at the same time, as Mario just mentioned, we're investing in transforming growth to increase our profit liability business. We have upside in front of us on the investment portfolio, and we're having a good successful expansion of our circle of protection. So thank you all, and we will talk to you next quarter.

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