S&P Capital IQ

CONTENTS

The Allstate Corporation NYSE:ALL

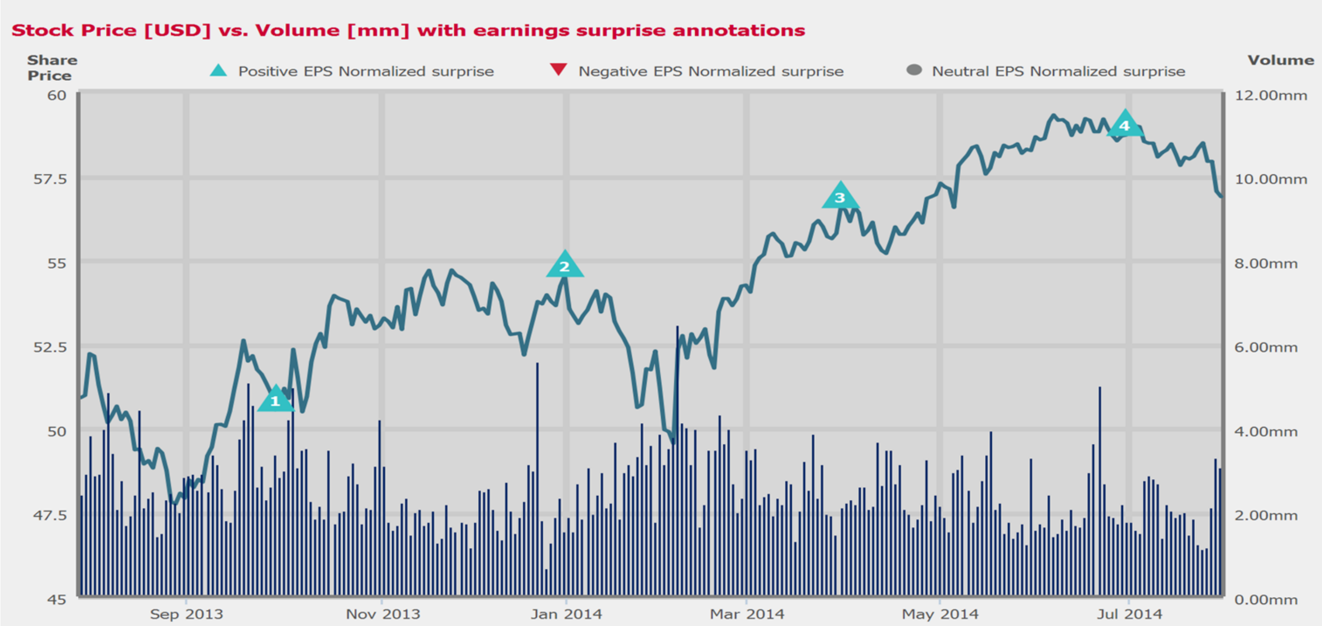
FQ3 2014 Earnings Call Transcripts

Thursday, October 30, 2014 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2014-			-FQ4 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.32	1.39	▲5.30	1.51	5.14	5.73
Revenue (mm)	7282.35	7307.00	▲0.34	7391.57	28993.67	30200.35

Currency: USD
Consensus as of Oct-30-2014 9:34 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2013	1.38	1.53	▲1 10.87 %
FQ4 2013	1.37	1.70	▲2 24.09 %
FQ1 2014	1.18	1.30	▲3 10.17 %
FQ2 2014	0.68	1.01	▲4 48.53 %

Call Participants

EXECUTIVES

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

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

Matthew E. Winter
President and President of Allstate Insurance Company

Patrick Macellaro

Steven E. Shebik
CFO & Executive VP

Thomas J. Wilson
Chairman & CEO

ANALYSTS

Amit Kumar
Macquarie Research

Jay H. Gelb
Barclays PLC, Research Division

John Arthur Hall
Wells Fargo Securities, LLC, Research Division

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

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Vinay Gerard Misquith
Evercore ISI, Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Allstate Third Quarter 2014 Earnings Conference Call. [Operator Instructions] As a reminder, today's program is being recorded.

I would now like to introduce your host for today's program, Mr. Pat Macellaro. Please go ahead.

Patrick Macellaro

Thanks, Jonathan. Good morning, everyone, and thank you for joining us today for Allstate's Third Quarter 2014 Earnings Conference Call. To begin, Tom Wilson, Steve Shebik and I will provide some color on our results for the quarter, and then we'll answer your questions. We realize there are other calls this morning so we've shortened our comments. [Operator Instructions].

Yesterday we issued our news release and investor supplement, filed our 10-Q for the third quarter and posted the slides we'll use this morning. These are all available on our website at allstateinvestors.com.

Our discussion today may contain forward-looking statements regarding Allstate's operations. Allstate's results may differ materially from these statements, so please refer to our 10-K for 2013, our 10-Q for the third quarter, the slides and our most recent news release for information on potential risks.

Also this discussion will contain some non-GAAP measures for which there are reconciliations in our news release and on our website.

We're recording this call and a replay will be available following its conclusion. I'll be available to answer any follow-up questions you may have after the call. And now I'll turn it over to Tom, for his thoughts on the quarter.

Thomas J. Wilson
Chairman & CEO

Well, good morning, everybody. We appreciate your interest and investment in Allstate. I'm going to start by providing an overview of the third quarter results, in particular how they tie to our strategy and our 2014 operating priorities. Then Pat and Steve will go -- provide some more context around results, then our leadership team will be here to answer your questions.

So in the room with us are Matt Winter, who leads Allstate personal lines; Don Civgin, who's responsible for Allstate Financial and Insurance; Kathy Mabe, who leads Business to Business; Judy Greffin, our Chief Investment Officer; and Sam Pilch, our Corporate Controller.

So let's begin with Slide 2. If you -- put simply, Allstate had a really good quarter this time. We continue to proactively take action, which is to enhance our competitive position, execute our strategy and deliver our current results. And while not everything is where it ultimately needs to be, most of the trends are in line with expectations. The strategy of focusing on unique value propositions for different customer segments is working. Growth increased, as we added almost 800,000 Property-Liability policies in force and increased annual net written premiums by $1.4 billion over the trailing 12 months.

Financial results for the quarter were also excellent. Net income was $750 million for the third quarter. As you can see, that's in the table on the bottom, which is significantly higher than last year's third quarter. But you remember last year, we reported the initial loss estimate on the sale of Lincoln Benefit Life in 2013 results.

Operating income for the third quarter was $1.39 per share.

The Property-Liability business generated good combined ratios in aggregate, despite catastrophe losses and investments in growth. Allstate Financial had good growth in the voluntary workplace benefits business with policies increasing almost 8% in the third quarter compared to the prior year quarter.

Allstate Financial returns were up, which reflects higher investment yields, lower expenses and a declining capital base.

We also made progress on our 5 2014 operating priorities and delivered strong cash returns to our shareholders.

If you go to Slide 3, that breaks out the Property-Liability operating results for the 4 customer segments. Starting at top of the slide, Property-Liability policies in force increased 2.4% and net written premiums were 4.9% higher than the prior year quarter. Overall, profitability was strong with the Property-Liability recorded combined ratio of 93.5, which included 7.1 points of Cat losses. The underlying combined ratio for the third quarter was 86.1, which brings that year-to-date total then for the first 9 months to 86.4, which is better than the full year outlook range of 87 to 89 that we provided in February.

The Property-Liability results by customer segment are shown on the bottom half of the page. If you start with the largest segment, served by the Allstate agencies, that's in the lower left, profitability was good across all products and Matt's team continues to execute a comprehensive profitable growth plan. We continue to have broad-based auto policy growth, which is 2.6% higher than the prior year. There was also a modest increase of about 0.1% in homeowners, and other personalized policies were 1.7% higher than the prior year.

Esurance, which is in the lower right, had policy growth of 14% over the prior year quarter, which is a decline from last year's growth rate, reflecting the profit improvement initiatives. Growth investments continue to have a negative impact on the recorded combined ratio. And as we discussed in prior quarters, Don's team is focused on reducing the underlying loss ratio, which at 75.3 was about 2 points better than the prior year.

The lifetime profitability of growth at this loss ratio is above our cost of capital, so we remain committed to increasing market share in this segment.

Encompass, in the upper left, has slowed growth, particularly of its packaged [ph] policy offering as they expand profit improvement initiatives. Encompass' path to growth under Kathy will be first to improve profitability.

Answer Financial, in the upper right, sold nonproprietary policies through the web and call centers. Nonproprietary premiums increased almost 10% over the prior year quarter.

So if we go to Slide 4, our 5 2014 operating priorities are shown there. And since we just discussed both growth and profit, I'll focus on the remaining priorities. We experienced another good quarter of investment returns. The total portfolio return in the quarter was 0.4%, but it's 4.7% for the first 9 months of 2014, reflecting the proactive approach taken by Judy's team. Net investment income, however, was lower than the prior year quarter, as strong limited partnership income was not enough to offset the impact of the $12 billion reduction in the portfolio because of the sale of Lincoln Benefit Life.

Modernizing the operating model will improve the customer value proposition by enhancing customer service and lowering cost. This includes simplifying technology applications and using continuous improvement to improve effectiveness and efficiency.

We also are looking to build long-term growth platforms. So to increase growth in our largest customer segment, we're building on the existing comprehensive growth plans by helping Allstate agents become trusted advisers and expanding into more local markets. Our broad product line, household focus and innovation by Good Hands Roadside and Drivewise further enhance those customer relationships.

The Drivewise telematics offering, we've expanded that to include a mobile phone application, which is now in 16 states, so we can compare the utilization of that method to the devices that are tied to the car's OBD ports.

Esurance's advertising messages of insurance for the modern world and 7.5 minutes, not 15 minutes, has further strengthened the brand for self-serve customers. Our broader product line, geographical expansion and more sophisticated pricing will also support market share gains.

So in summary, Allstate had strong results across a number of fronts in the quarter. The strategy to better meet the unique needs of customers and proactively manage both investments and capital continues to serve our shareholders well. So let me turn it over to Pat.

Patrick Macellaro

Thanks, Tom. I'll begin by reviewing the Property-Liability highlights on Slide 5. Beginning with the chart on the top of this page, Property-Liability earned premium of $7.3 billion in the third quarter, was 4.8% higher than the third quarter of 2013. Recorded combined ratio of 93.5 increased 3.5 points versus the third quarter of 2013 driven by increased catastrophe losses. The underlying combined ratio was 86.1 for the third quarter, bringing the year-to-date result to 86.4.

Net investment income for the Property-Liability segment increased 11.3% from the prior year quarter, driven primarily by limited partnership income. Property-Liability operating income in the third quarter was $553 million, 19.3% lower than the third quarter of 2013, which, as you may recall, was a very benign quarter in terms of weather.

During the third quarter, the annual review of discontinued lines and coverage reserve levels led to an increase of $102 million in reserves, most of which pertain to asbestos liabilities. This increased the Property-Liability recorded combined ratio by 1.4 points for the third quarter. Reserves were increased by $133 million in the third quarter of 2013 as a result of last year's annual review.

The chart on the lower left shows net written premium and policy-in-force growth rates for Allstate Protection. The red line shows the continued positive policy growth trend that began in the second quarter of 2013. Policies in force have grown by 2.4% from last year's third quarter and 1.8% from year-end 2013.

The exhibit to the right of this chart highlights the Property-Liability recorded and underlying combined ratio trends, as well as results by brand. Esurance's underlying loss ratio of 75.3 for the third quarter of 2014 is also shown to isolate the impact of ongoing profit-improvement actions from the impact of growth investments.

Moving to Page 6, we show the components of premium and policy growth by brand. Focusing on the Allstate brand in the upper left chart, policies increased by 572,000 in the third quarter, which is 1.9% higher than the third quarter of 2013, driven by both favorable new business and retention trends. The Allstate brand grew net written premium by 4.5% in the third quarter versus the prior year quarter as average premiums continued to increase.

Total growth in net written premium was driven by a 4.9% increase in the Allstate brand auto and a 2.9% increase in Allstate brand homeowners compared with third quarter of 2013.

Moving to the chart on the right-hand side, you can see the policy-in-force growth trends for Allstate brand auto and homeowners going back to 2005. Current results compare favorably to recent history due to having substantially completed the repositioning of the homeowners business. In this quarter, Allstate brand auto policies rose by 504,000 or 2.6% from the prior year quarter. Allstate brand homeowners rose by a modest 5,000 policies from the prior year quarter, which is indicative of continued progress in leveraging this product as a competitive advantage versus monoline auto carriers.

Allstate brand auto -- Allstate brand policy growth is geographically broad-based and reflects both better customer retention and new business sales. There are currently 42 states growing Allstate brand auto policies and 21 states growing Allstate brand homeowner policies versus the prior year.

Esurance's read of premium and policy growth in the lower left continues to slow due to ongoing pricing and underwriting actions underway to ensure a long-term profitable growth as well as Esurance's increasing size. Total Esurance premium grew by 14%, policies in force grew by 14.1% in the third quarter compared with the third quarter of 2013. Spending on expansion contributed approximately 2 points to the combined ratio in the third quarter.

Encompass policy-in-force growth, highlighted in the lower right, also continues to slow, reflecting actions taken to ensure acceptable long-term returns. Net written premium growth of 4.3% in the third quarter compared with third quarter of 2013 includes the impact of higher average premiums that are the result of the profit improvement plan.

Slide 7 highlights Allstate brand auto and homeowner underlying margin trends. The charts on the left show Allstate brand auto and home recorded and underlying combined ratio trends, while the charts on the right show the components of the quarterly underwriting combined ratio.

As you can see on the charts on the left-hand side, while there's volatility in the recorded combined ratio trends from quarter-to-quarter due to catastrophes, the long-term underlying combined ratio results have been both very good and stable for auto insurance and steadily improving for homeowners.

The Allstate brand auto under its [ph] current premium continued to increase in the quarter, up 1.7% from the prior year quarter.

Premium increases have been improved in 35 states so far in 2014, reflecting an organizational focus on maintaining margins by making frequent adjustments based on actual results. The underlying losses and expenses per policy increased slightly in the third quarter by 1/10 of 1% compared with the third quarter of 2013. This resulted from a lower frequency of claims and expected increase in severity of losses, along with the benefit from the lower expense ratio.

We experienced similar results in the third quarter for Allstate brand homeowners. Average underlying losses and expenses per policy reflect prior year quarter and average earned premium continued to increase, although at a slowing rate, as more states approach rate adequacy. Allstate brand homeowners underlying combined ratio was 60 in the third quarter.

We're continuing to take rate increases and make underwriting and product changes as needed to continue to keep pace with loss trends and maintain the underlying combined ratio in both of these lines.

Now I'll turn it over to Steve, to cover Allstate financial, investments and capital management.

Steven E. Shebik
CFO & Executive VP

Thanks, Pat. Turning to Slide 8, our strategy is for Allstate Financial to become more strategically integrated with the Allstate brand's customer value proposition.

Allstate Life and Retirement has been refocused on the Allstate agencies, but the integration in the Allstate brand customer value proposition will require a multi-year effort. The chart on the bottom of this page highlights operating income by quarter, including and excluding the impact of the sold Lincoln Benefit Life business.

Operating income for the quarter was $125 million, 1.6% lower than the third quarter of 2013, but higher when excluding LBL results from the prior year. Operating income return on equity has continued to improve given our efforts to focus the business; a lower cost structure; strong investment income over the past 4 quarters, reflecting limited partnership income; and the $1.2 billion return of capital by the Allstate Life Insurance Company over the past 12 months. So that estimated historical results with Lincoln Benefit Life are provided on our third quarter 2014 10-Q and the investor supplement to provide you with further context.

On Slide 9, in the top left graph, you can see the composition of the investment portfolio and the impact of the sale of Lincoln Benefit Life, which reduced the size of the portfolio by $12 billion. We are taking a measured approach over time to shift the portfolio composition from fixed income assets to equity and other assets, where returns are driven primarily by idiosyncratic performance.

Our equity and owned portfolio is lower compared to the prior year end primarily due to the reclassification of tax credit investments to other assets and the sale of approximately $300 million of limited partnership positions.

Our total portfolio return, presented at the top right, was 0.4% for the third quarter as investment income of 1% was partially offset by lower fixed income and equity valuations. You can see the valuation impact varies from quarter-to-quarter, while the income yield has remained relatively constant.

Total return for the first 9 months of 2014 was 4.7%. The lower half of the slide provides the investment income and yield for the Property-Liability and Allstate Financial portfolios, each of which comprise approximately half of the portfolio. This approximate equal split reflects the strategic decision to deploy capital out of Allstate Financial.

The Property-Liability portfolio in the lower left graph shows the interest-bearing yield has stabilized after our 2013 rate risk reduction actions and illustrates the variability in income that may result from limited partnership and other equity investments. The Allstate Financial portfolio, in the lower right graph, has a more stable yield due to the longer duration of these investments and the limited reinvestment activity. The decline in quarterly income versus the prior year is due to the sale of LBL.

Allstate Financial's portfolio has been reduced through a variety of actions that resulted in a decline of total invested assets from a peak of $78 billion in the first quarter of 2007 to $39 billion in the third quarter of 2014.

Slide 10 provides an overview of how our capital structure has changed over time. On the left-hand side of the page, you can see the capital structure at the end of 2012 compared to the third quarter of 2014, and the shift from predominantly senior debt to include more hybrid debt and preferred stock, increasing both our strategic and financial flexibility.

With the repayment of $650 million of senior debt in August, the capital restructuring plan we started early last year is complete. That said, we constantly evaluate alternative sources of capital to lower our cost or decrease volatility in order to create additional shareholder value.

Shareholders received cash returns of over $1 billion in the third quarter, as we repurchased $926 million of common stock and paid $122 million in common stock dividends. Through the first 9 months of the year, total common shareholder cash returns were $2.42 billion, including quarterly dividends, the completion of one $750 million accelerated share repurchase program, the initiation of a second $750 million accelerated share repurchase program and open market purchases. We have now completed just over 75% of the $2.5 billion share repurchase authorization approved in February in about 40% of the authorized 18-month repurchase period.

Book value per common share reached $48.28, increasing 6.6% since year end and 11% since September 30 of last year. Operating income return on equity was a strong 13% in the third quarter on a trailing 12-month basis, but lower than the full year 2013 return of 14.5%, reflecting the impact of higher catastrophe losses in the first 9 months of this year and a higher equity base. As I mentioned last quarter, much of the increased equity is a result of the positive impact of the 2013 change to pension and retiree benefits and plan assumption changes.
Now let's open up the call for your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Michael Nannizzi from Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

First question, can you -- Tom, could you talk a little bit about the other personal lines business? That roughly $2.5 billion of premium. What were the trends in that line up from a profitability perspective?

Thomas J. Wilson
Chairman & CEO

Sure, let me provide some overall context and then Matt can give you some specifics by line. But first, as you know, in that customer segment, where they want local advice and branded products, that is -- that's served by the Allstate Agency. They want to buy most of their stuff from the same person. The logic is that I don't want to have to have a relationship with somebody to buy auto insurance and home and boat and PUP policies and renters policies. So we try to -- we do offer them a broad range of stuff. And we have -- Matt's team has been working on more of a household focus, which includes those policies. So we've, of course, sold those for years. I think we have about 5 million policies in total in force, when you look at them in total. Matt can take you through sort of both the growth trends, where we've had some good success, and profitability.

Matthew E. Winter
President and President of Allstate Insurance Company

Thanks, Tom. Thanks, first of all, for asking about the other personal lines. We often get through call without ever mentioning these. And as Tom mentioned, we're trying to incorporate all the products a customer might need within the Allstate Agency value proposition. And so we've had an increased emphasis on the other personal lines products. As you know, there's a wide group of products grouped within this category, and we do, do the breakdown on the -- in the investor sup on both Pages 15 and 30 that gives you some of the net written premium trends and the policy-in-force trends. What you see on the profit side is we've had a fair amount of margin actions this year in the landlord, manufactured home and the PUP areas. And so that has suppressed some of our IIF growth, because of those margin actions in those lines. Most of our item-in-force growth has come from renters and condo, which are where we need them to be from a profitability standpoint. We did have some decline in involuntary auto, as more companies are willing to take on more of those drivers. That somewhat dampened our growth. But overall, when we look at our other personal lines products, other than the work that we have ongoing in landlord, manufactured home and PUP, we feel very good about the profitability, very good about the growth prospects in all those individual product areas.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And could you provide sort of an underlying or just an indication of kind of where that business is running maybe relative to auto and home?

Thomas J. Wilson
Chairman & CEO

Well, you can see that on Slide 3, Mike. The combined -- the recorded combined ratio for other personal lines for this quarter was 85, that compares to 81 for home and 93 for auto. And as Matt pointed out, there's a wide range of products, so the capital under those products varies significantly. [indiscernible] returns.

Matthew E. Winter
President and President of Allstate Insurance Company

You might also look, Mike, Page 23 of the investor sup, shows the loss ratio, cat ratio, expense ratio and combined ratio for that category.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it, great. And then just in terms of the homeowners lines, so now that's ticking on the plus side for the first time in a while, and the new issued apps [ph] seem to be moving in the right direction. Can you kind of talk about what you expect there? I mean, do you still see opportunities now for PIF growth to move further into positive territory? And what are the factors driving that? And how should we think about the interaction between that and auto if you look to get more on the offensive there?

Thomas J. Wilson
Chairman & CEO

I'll provide a longer term perspective and Matt can talk about -- well, his current growth plans and the profit improvement plans because while we're happy with the overall combined ratio where it is today, this is -- it's a country with 50 states and -- and a couple of territories, and so we have to do things differently in each of those and so they're not all perfect. But if you -- there is -- we put in a slightly longer view. If you really look at homeowners in total, I think, it peaked, Mike, about 7.8 million policies and it's a little above 6 million now. And it's really been coming down since the '06 period of time, where we started taking pretty drastic action in, at the time, relatively narrowly focused cat areas, being Florida and Louisiana, a few places. Then as the weather got worse in '08 and '09, we expanded that activity by both increasing prices and, as importantly, our re-underwriting the book and making sure we like the individual properties we had taken risk on. And you can see, the business kept coming down on an overall items-in-force level. That does -- auto does track with it. If you look at our -- the growth rate of those 2, they track together. That said, we weren't willing in the depths of the -- getting smaller in the homeowners business to give ourselves a complete out for that because there are, of course, monoline auto companies that grow and we felt that we should be able to grow as well. It's a little harder though when you're telling somebody, "I'm not going to insure your house. Please keep your auto with me, then please give me your auto if you don't have it." So they do trend together, but they are also separate. And so auto has had higher growth rates over the last couple of years than home has. Home has finally ticked positive. It's 5,000 on 6 million. That doesn't count as sustainable growth. So Matt can talk about what they're doing to get sustainable growth out of that business and how it turns into a competitive advantage for us relative to both the local advice and branded Allstate segment, and -- but we won't go there right now. But you also know we're adding this to the Esurance platform as well so that they can be in that segment.

Matthew E. Winter
President and President of Allstate Insurance Company

Thanks, Tom, and Mike, thanks for the question. As you noted, this is the first quarter since 2006 that we grew items on a year-over-year basis. And while it's by a small number of policies, it's pretty widespread, widespread geographically and widespread in terms of its drivers, being both favorable new business and retention. As Pat noted in his opening remarks, we now have 21 states that are growing year-over-year. New business is 12% above prior year, and we actually have 36 states with higher new business levels than last year. As we've talked about on previous calls, we've been putting in House & Home. House & Home growth has been higher than our countrywide average. And as we've also discussed, House & Home gives us some benefits on the profitability side in that it normally goes in rate adequate when we launch it. And due to its product design, tends to be more stable and tends to require less rate. And so it gives us a competitive advantage in terms of stability in the marketplace. On the retention side, retention in homeowners continues to improve. We're now up 1.2 percentage points since 2012, and we have 38 states that are above prior year retention levels. What's interesting to us is that while we monitor both first and subsequent retention, and both are showing favorable trends, we've noticed that subsequent retention has now reached its highest level since 2005. So we feel quite good about the new business growth. We feel quite good about the retention trends and we feel quite good about the profitability of that business to enable us to maintain that trend line. So we believe we have more room to go. We did have some benefit of opening up in some PML areas that had previously been closed, where we figured diversification benefit was worth allowing small policy growth there. But by no means do we feel like we've capped out. We think we have geographic areas within the United States that are under-penetrated compared to what our market potential is. And we think we have room to grow as we expand our agency footprint in some of those areas. So we're cautiously optimistic about the future.

Operator

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

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Question on Allstate Financial. Where is the expense structure relative to where you want to be without LBL? You mentioned expenses, I think, is bullet 4 or 5, as a priority, but what sort of timing should we expect on getting the expenses rightsized to the smaller operation?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Bob, it's Don. Thanks for the question, and thanks for noticing that the expenses are down. Sometimes, it's thankless work, but I appreciate you pointing it out. The Allstate Financial strategy, which we've been consistently following for the last 4 or 5 years, really results in a business that's smaller and far better aligned with the Allstate customer value proposition. Part of that -- and Steve mentioned how much smaller the investment assets are. A lot of that happened actually over the course of the last 4 years or so, even though we pointed out a 7-year timeframe. And so that has put a lot of pressure on the expense structure. We're down this year about 22% in Life and Retirement business. I'll exclude Allstate Benefits, because they're growing. But in the Allstate Life and Retirement business we're down about 22% in expenses from last year's quarter. I expect those numbers to continue coming down some. But we're getting to the point where we're about the right size -- or the expense structure is about the right size for the company. What we really want to do now is make sure that we're focused on supporting the customer, the Allstate customer, through the Allstate agencies and generating some growth for the company. I think that's going to take a bit longer to get through the transition with Lincoln Benefit Life. But the expense piece of it has come down nicely, and we still have a little bit more to go.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

And the follow-up is on auto. With gas sub $3 in a lot of areas, are you pricing for increased frequency yet? Or you're waiting to see what will happen?

Thomas J. Wilson
Chairman & CEO

Okay, Bob, Bob, I love the follow-up from the life to auto. But I love you anyway. Matt can talk specifically about all these, of course. Frequency has all kinds of components in it, right? It's got miles driven, it's got who drives the car, it's got -- that's affected by a lot things including gas prices. The biggest driver historically, from our analysis, which is kind of hard to get between that, is really on the economic growth. So people are working, unemployment rates are down, economic activity is up, people are going to restaurants, they're driving places. And so as you look at the progress, and of course, unemployment and economic activity has trended up for the last 3 or 4 years. Matt's team has reflected that into the results, and you see we've been able to maintain ratios. Gas prices may have an impact on mileage driving. And we track it. It's not as close, right? Because gas prices aren't really that significant a cost that they keep people from driving. So if you're paying $4 a gallon and you suddenly pay $3 a gallon, even if you're getting 10 miles per gallon, you're saving $0.10 a mile. It's not really a barrier to people going places. That said, you tend to get more like summer driving vacations and stuff like that. I would just say Matt's team has proven their ability to micro-target that stuff and drive it in a way there. So Matt, if you want to make comment about frequency and profitability?

Matthew E. Winter
President and President of Allstate Insurance Company

Sure. Thanks, Tom. I don't really have much to add as far as the gas price impact. As Tom said, it's something we'll watch and watch carefully. But we don't expect it to be a core driver. That being said, our frequency so far has been extremely favorable to prior year. It's within our historical ranges, it's broad geographically. So our frequency trends are -- have been good. We stay on top of them, as Tom says. This is a national business managed very locally. And so even if the change in gas prices drives behavior and miles driven in some small geographies, it will be geographically specific. It won't be widespread. And so we'll manage it that way, and we'll continue to do what the company has been quite good at doing. As you see on page 7 of our presentation, we have a pretty long-term history of managing our margins well and keeping an eye on both frequency and severity and reacting accordingly. So it's something to watch, but not something to obsess over.

Operator

Our next question comes from the line of Jay Gelb from Barclays.

Jay H. Gelb
Barclays PLC, Research Division

The first topic I want to cover is on reinsurance cost. Reinsurance costs appear to be coming down pretty dramatically over the course of this year and probably into next year. Could you update us on your reinsurance protection strategy in terms of whether you expect those savings to fall through to the bottom line? Or perhaps you've used a portion of those savings to buy more coverage?

Thomas J. Wilson
Chairman & CEO

Steve, do you want to talk about the [indiscernible]. Jay, we redid those programs in June. It was just -- even if current -- if pricing is lower today than it was in June, we put our plan in place. It was a multi-year plan.

Steven E. Shebik
CFO & Executive VP

So Jay, this is Steve. As Tom said, we put in place a multi-year plan, the core reinsurance is a 3-year plan rolling 1/3, 1/3, 1/3. And this year, well, actually last year and going into this year, we started issuing catastrophe bonds again, which we had not done for about 5 or 6 years. This year in particular, we issued over $1 billion and it was in excess, I think, of $2.75 billion if I remember it correctly. So the core part of the program is really subject to the changing pricing in the reinsurance market. But it would only be -- kick in about 1/3 at a time each year going forward. And as you know, our pricing is adjusted for reinsurance costs, so that kind of bleeds into the pricing over a period of time. We did take the chance -- opportunity this year for the lower -- with the lower prices in the core reinsurance market to buy more coverage up top, so -- and also at the bottom. So for those several years, we've had a first event $750 million retention, we lowered that to $500 million this year, and we increased the amount of coverage on the topside of the program. So we have the best coverage, I believe, we've ever had. And we have multiple sources, both the traditional reinsurance program and the catastrophe bonds that are 4- and 5-year maturity type bonds. So we're covered over a longer period of time.

Thomas J. Wilson
Chairman & CEO

Jay, this is Tom, maybe to take it up a level in terms of capital management. We kind of look at reinsurance as just capital at this point. And so Steve talked about how we use it to reduce volatility. We, of course, are trying to be proactive everywhere in the capital structure. So we put a bunch -- as Steve pointed out, we took a bunch of debt out, put on preferred, put on hybrids, which lowers our cost of capital and puts us in a really strong financial position. As the market develops, I think what you're seeing in reinsurance pricing is really the growth of -- the increased interest in insurance-related investments and assets. And so we think you'll continue to see new forms of alternative capital being developed, which will enable us to either lower reinsurance costs, take advantage of other things in the capital structure or find other ways to lower our cost of capital or take volatility out of the business.

Jay H. Gelb
Barclays PLC, Research Division

That's helpful. On the capital management front, Tom or Steve, I find it interesting that Allstate appears to be moving towards share buybacks and dividends being in excess of annual operating earnings. There's only a few companies in the property-casualty sector that did that -- or have done that so far, mostly on the commercial line side, but Allstate doesn't have the pricing pressure they're facing. So can you update us a bit in terms of level of magnitude and in terms of what you're thinking on the pace of buybacks and dividends relative to earnings?

Thomas J. Wilson
Chairman & CEO

We don't -- I know some of the banks, Jay, do it that way. They say 80% of their earnings. We don't do it that way. We obviously look at it relative to how much capital we have, which is dependent on earnings. But we look at how -- for example, some of the things, we got rid of -- we've reduced, as Steve pointed out, we've reduced the size of the Allstate Life and Retirement balance sheet by about $40 billion, which is equal to some life insurance companies. And so the capital that supported that, we either can deploy in growing our property casualty business or in giving it to shareholders. We -- included in that was the sale of Lincoln Benefit. So that's been factored in. We don't forecast where we'll go after we get done with this share repurchase program. But Steve's been very aggressive in buying back the current shares because we have plenty of capital, and we're feeling good about returns. And we do want to keep that capital and have our ROE go down.

Operator

Our next question comes from the line of John Hall from Wells Fargo.

John Arthur Hall
Wells Fargo Securities, LLC, Research Division

I have a question starting with Allstate Financial. In the quarter, there was a fair amount of difference between the third quarter and the second quarter operating earnings. I was wondering if we're at a level that we can start to think of building off of the third quarter going forward.

Thomas J. Wilson
Chairman & CEO

I'll give my view. Steve and Don may have their own views. I think this quarter looks more like the future than last quarter, John.

Yes, I think they're going to agree.

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

No one is answering, so I think we all agree.

Thomas J. Wilson
Chairman & CEO

We're not -- we don't do forecasts by line or by company or something like that. But you had some increased limited partnership returns last quarter, the second quarter of this year than this year. Now I will point out, I know there's been some questions from people about the volatility about limited partnership returns. And yes, it is true that limited partnership returns are more volatile. But that's specifically why we break them out for you, and it's also specifically why we do it. And so if you think about that, our investment philosophy is get a good risk adjusted for return, not to try and optimize any given quarter. And then we -- the return -- we look for attractive returns. And because these investments are volatile, they tend to get higher returns. And it also puts another -- with the idiosyncratic or the asset-specific concentration on investment results, it puts some diversification into the portfolio rather than just the market. So it's a good reason for that standpoint. And also if you look at our overall volatility, we've reduced volatility in the investment portfolio because of interest rates. You see that in lower operating income, but if you look at how we've shortened the duration in the Property-Liability portfolio, that's reduced volatility. While this injects a little more volatility, we think it's volatility that is higher return than just keeping interest rates -- our duration out there. So we thought the trade between the 2 and the risk return. And then if you look at the volatility across the company, and go up a level, while I know this makes it harder for you all to forecast what that -- the limited partnership returns will be, and then hence, what Allstate Financial's returns will be. If you look at the volatility in the overall company P&L, we have plenty of places. We've have plenty of volatility and this is just an uncorrelated piece of volatility. So we have catastrophe volatility, frequency volatility and then the partnership volatility. But we spike it out so you can get it, but we think overall, it's exactly the right thing to be doing with our investments, even though it creates a little bit of confusion as to, is your run rate 150 or 125.

John Arthur Hall
Wells Fargo Securities, LLC, Research Division

Great. No, that all make sense. And you sort of got to my follow-up, which had to do with whether you're making any changes to the investment portfolio allocation towards these types of investments.

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

So this is Judy. And yes, we are changing our allocation towards these types of investments. As Tom just said, we like this trade off versus interest rates currently and, frankly, into the future. But we're doing that at a measured pace. There's no denying that the market is pretty fully priced in terms of valuations. So we're looking at the space, we like the space over the long term. It's just finding the right investments for us, and those idiosyncratic investments that we think will deliver higher returns again, over the long-term.

Thomas J. Wilson
Chairman & CEO

And Judy, you're highly diversified in the space you're in right? So if...

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

Yes. Within the overall portfolio, we're highly diversified; and then this part of the portfolio, we're highly diversified as well. And you can see that in the Q, we break that out.

Operator

Our next question comes from the line of Amit Kumar from Macquarie.

Amit Kumar
Macquarie Research

Two quick questions, the first question is on loss-cost trends. Can you talk about what you might be seeing in Personal Injury Protection, auto severity trends, concerning the fact that one of your competitors pointed out to a 17% increase recently?

Thomas J. Wilson
Chairman & CEO

Well, of course you know PIF coverage is in about 5 states. I'm not sure what their 17% was, if that was one state or across the country. It seems like a pretty -- it seemed high to me if it was across all 5 states. If it was us, we'd be really worried about that. I don't know if they are or not, and I don't know who you are talking about at this point, but I'll soon find out. Matt, do you want to talk -- it's really a relatively highly focused, but important question, because those states tend to be pretty large states, being New York, Florida, Michigan, anyway, Matthew?

Matthew E. Winter

President and President of Allstate Insurance Company

So as Tom said, I'm not sure specifically who you're referring to. So I can't comment on what they might have said. Obviously, PIF and BI are things that we watch constantly. They tend to be somewhat volatile. And they move around and bounce around. And if they're not managed carefully, they can get out of control. We watch them carefully and we react in a variety of different ways, depending upon the geography. In some cases, it's pricing action, it's -- in other cases, it's underwriting actions. In other cases, it's managing where we're growing and where we're not. And so we'll continue to manage those 2 coverages fairly aggressively. We're not seeing anything get out of control from our perspective, I can say that. We're seeing normal volatility that we would expect. But we're not seeing anything out of control.

Thomas J. Wilson
Chairman & CEO

I would -- a couple of things I would look at too if -- on the subject [ph] without trying to [indiscernible], but I'd first look at their size of the book, if they have a small book. I'd also look at what happened the prior year. That -- as Matt pointed out, that PIP line could be highly volatile. You get some pretty good cases in there, and all of a sudden, the quarter-over-quarter looks really wild, but the absolute level looks okay in the long term. So I don't know whether something has a problem or not. There's also the claim procedures and the schedules in which we operate. And sometimes you can't control that, which is -- so they'll put a schedule in to say chiropractors get a certain amount of money, and you have to pay according to that. So it doesn't mean that the company's not well managed, it just means you're doing what you're required to do. But the way in which you manage that is exactly what Matt said, which is you're keeping -- paying attention to it and either you're controlling your cost and making sure people get the right amount of money or you're changing your pricing. And as he pointed out, we were -- we have -- I think, when people look at our business on profitability, they tend to take a commercial lines perspective and look at sort of price and loss cost, and assume it's all about price. We really have a system. And you really have to think about the system, how it works at a granular level, which makes adjustments all the time. And it's that system that's generated the good combined ratios in auto insurance for a decade. And it's managing and leading that system which we have to do to make sure we get good returns.

Amit Kumar
Macquarie Research

The only other question I had was going back to the discussion on telematics and I think you mentioned the mobile app is in 15 states. What I was wondering was, why not skip the OBD or the app step and work directly with car manufacturers? We all are talking about the connected car concept. Why -- what would preclude you from working out some sort of arrangement with, let's say, the big 3 car manufacturers and installing something on those vehicles which allows the customer to get a code from Allstate.

Thomas J. Wilson
Chairman & CEO

It's a good question and the answer is nothing, but it wouldn't be comprehensive, in part because the average age of the fleet is 11 years. And so there's a whole bunch of people out there driving that we'd like to offer them the opportunity to get more sophisticated pricing and a better driving experience now as opposed to waiting until they buy a new car. So we're actively in conversations with everybody. And that range of potential participants in the connected car, obviously, includes the OEs, the auto manufacturers, but it also includes the telcos. Some of the telcos are interested, some of the other connected customer technology companies are interested. So we're active in all the fronts. We'd like to think of this as a tremendous opportunity for our company. And it will evolve, and so we're trying to put as many oars in the water as we can so that we at least stay with the tide, if not get ahead of it.

Operator

Our next question comes from the line of Josh Stirling from Sanford Bernstein.

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

So I thought I'd ask a big picture question about Esurance. I'm wondering if you can walk us through how you guys are thinking about the economics of ad spend, really rough numbers. It kind of looks like you spent maybe $500 million, $600 million on advertising since you've bought the business. You've driven a similar amount of new business growth. And so I'm curious on how you think about or we should think about what the returns of that investment would be. And big pictures, is this something where you should be advertising more if you could scale up the organization and you can handle the level of growth?

Thomas J. Wilson
Chairman & CEO

I'll give you a strategic answer and Don can jump into the specifics, and we look at it both ways, Josh. So certainly, we think it is an important growth element in our plan. So we -- to a certain extent, if you go way up, what we've done is we now have a diversified set of growth opportunities with -- inside the Property-Liability space. We've traded some of that off for diversification and growth opportunities by reducing the size of our life business. So we used to have -- so we have -- and we had this opportunity with a highly focused customer value proposition to go at that self-serve space and really take on GEICO and Progressive Direct head on with, in our words, out self-serve them. And so that's why we talk about 7.5 minutes, not 15. We also are good at that. The reason that diversification by customer segment works is because it's something we're really good at, both pricing, settling claims, and all that has turned out to be true in aggregate for us. I think the business is up about not quite double yet, we're about 80% bigger than when we bought it. And you're right, we've invested a lot of money in it. We also think we've enhanced the underlying processes, not all of which you see in the current P&L, because we continue to invest aggressively in, like, rolling out homeowners, motorcycle, renters. I think that, Don, that's eaten up a couple of points of profit just last quarter. So we continue to invest in that. And we think it's an opportunity for us to compete more directly and stop them from coming to compete with the -- in the multiline customers in the lower left. And so we like the portfolio approach it gives us. So that said, we like the deal, we're glad we paid a lot of money for it. And we're even happier that it's turned out to be growing and we're going to make money on it. As it relates to the individual annual amount, that gets balanced a couple of ways. One is we look at our overall profitability of the company. And I like there to be a balance between that. So while we certainly could spend more money, I don't want to put too much pressure on other parts of the business that also have growth opportunities. We've got lots of places we can grow. Matt's adding agencies, Kathy's growing the benefits business. We've got plenty of places we can grow. So we try to balance it in the overall portfolio of growth opportunities. And then Don looks specifically at the returns and the efficiency curve, so to speak. So Don, you might want to talk about how you figure out where the efficiency curve is and then the economics by kind of segment.

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Yes, Josh, it's -- clearly as Tom said, the Esurance acquisition was done to give us a strategic advantage with that particular customer segment, not to make our GAAP results easier to explain. And it has grown -- 14% growth this last quarter, on top of 27% last year, it's been growing really nicely. But it forces us to balance between the growth and the profitability. The way we run the company, the objective function is to grow it as quickly as we can while maintaining the economics so that the returns are above our cost of capital. Now that requires balancing a few things. So if I look at this year's result so far, we've been working hard on the loss ratio. That came down a couple of points again this quarter. It's down a little bit more than that year-to-date. We feel really good about the loss ratio. The expenses year-to-date are lower if you take out advertising. And then as Tom mentioned, we've got a couple of points of investment in things like motorcycle, homeowners, renters, other product launches and so forth. And what we're really trying to do then is balance how much we spend on marketing with the acquisition cost that creates so that we can continue to manage our combined ratio on a lifetime basis to be something under 100. Should we -- if we wanted to strategically, we could relax some of those constraints. But as Tom said, we don't want to use more than our share of the resources of the company. And they're growing really nicely. I mean, the fact that they're up 80%, 85% since we bought them and still running on a sustainable economic basis is good. So that's the construct under which we're operating. We'll continue to balance that kind of quarter-by-quarter as it relates to marketing. But my suspicion is we'll continue to see improvements in loss ratio because it's been a focus area, which will allow us to spend a little bit more on acquisition and still make the equation work.

Patrick Macellaro

Jonathan, this is Pat, we'll take one more question.

Operator

Certainly. Our final question comes from the line of Vinay Misquith from Evercore.

Vinay Gerard Misquith
Evercore ISI, Research Division

Just one question. Management's stated goal has been to maintain the margin, and yet you've gone past it and done extremely well for the last couple of quarters. Curious as to whether you intend to keep this margin or do you think that your overrunning just a tad and would like to maybe just grow some more?

Thomas J. Wilson
Chairman & CEO

Well, as you point out, we're operating at the bottom end of the range that we provided to everybody in February. We provided that range to give you all a sense for how good we think the underlying economics are of the business, and we'll do that again in February, of the outcome here [ph]. We put a range on it obviously because frequency and severity can bounce around a good point each without actually -- the underlying -- the actual economics being just volatile as opposed to you've done something right or wrong. So we like where we're operating today. As you could hear from Don's comments, we're all in for growth, but it's got to be profitable growth. Sometimes we get growth and it's not profitable and then we shrink it. Other times, we get growth and it's profitable, a little more profitable than we think. So we toggle between those at a relatively micro level. But we don't have any desire to reduce our returns in auto or homeowners or our other businesses today to get more growth. We don't think we need to, we think we're accurately priced. We think the combination of our pricing sophistication, claim skills, distribution, unique value propositions, marketing, all that adds up to customer value where they're prepared to let us earn the economic rents we do. So we're happy with where we're at. So we're not looking to sort of say combined ratio's going to go up so we can grow another point. That's not a good trade for shareholders.

Well, thank you all. I know you've got an incredible amount of work between -- in the next couple of days. So thank you for listening. Our strategy is working, it's profit growth, shareholder returns. We're proactive in running the business. We have a number of initiatives underway, which will enable us to continue to do those things.

So we'll talk to you next quarter.

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