S&P Global
Market Intelligence

The Allstate Corporation NYSE:ALL

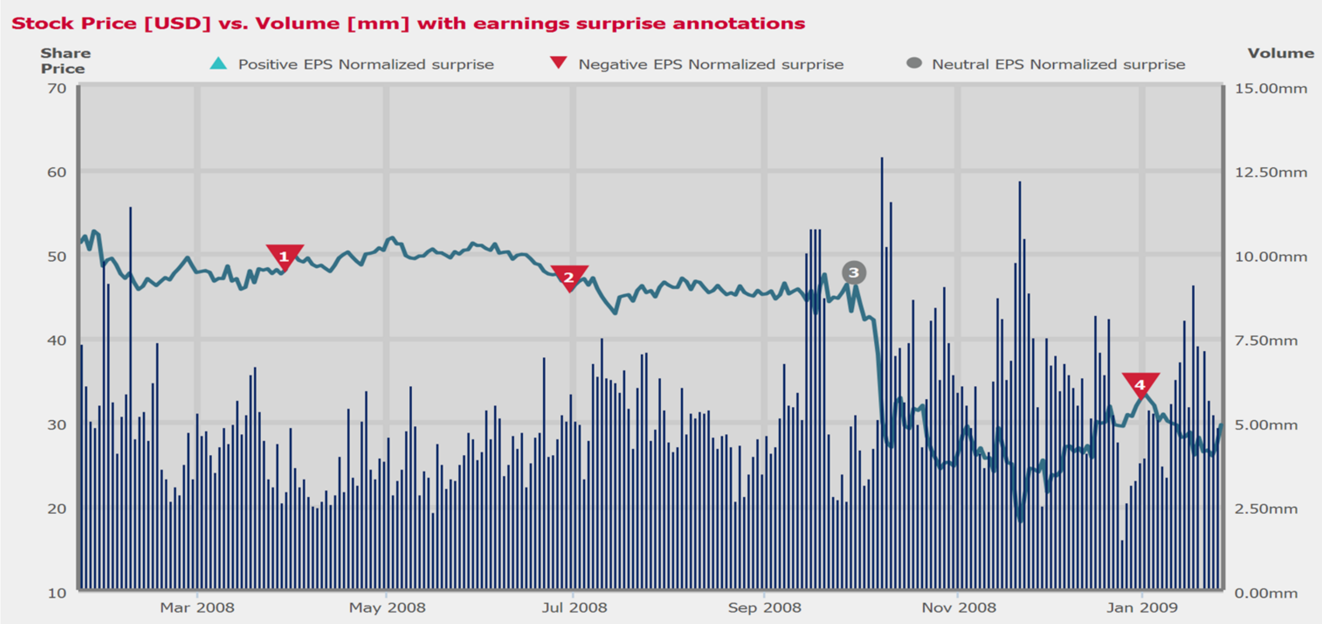
FQ1 2009 Earnings Call Transcripts

Friday, May 08, 2009 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2009-			-FQ2 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.23	0.84	(31.71 %)	1.19	4.29	4.37
Revenue	-	-	0.22	-	-	-
Revenue (mm)	6567.43	6582.00	-	6529.20	26303.14	26168.29

Currency: USD
Consensus as of May-08-2009 1:51 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2008	1.62	1.33	(17.90 %)
FQ2 2008	1.30	1.24	(4.62 %)
FQ3 2008	0.66	(0.35)	NM
FQ4 2008	1.35	0.97	(28.15 %)

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Call Participants

EXECUTIVES

Don Civgin

George Ruebenson

Judy Greffin

Robert Block

Thomas Wilson

ANALYSTS

Alison Jacobowitz
Banc of America-Merrill Lynch

Brian Meredith
UBS

Daniel Johnson
Citadel

David Lewis
Raymond James & Associates

David Small
JPMorgan

Ian Gutterman
Adage Capital

Jay Gelb
Barclays Capital

Joshua Shanker
Citigroup

Matthew Heimermann
JPMorgan

Robert Glasspiegel
Langen McAlenney

Unspecified Analyst
Perry Capital

Presentation

Operator

Good day ladies and gentlemen, and welcome to the Allstate Corporation first quarter 2009 earnings conference call. (Operator Instructions) I would now like to turn the conference over to your host, Mr. Robert Block, Vice President of Investor Relations.

Robert Block

Good morning, everyone. Thanks for joining us today as we discuss our results for the first quarter of 2009. This call is occurring later then in the past as we have moved our earnings release to coincide with the release of our 10-Q.

Last night we issued our earnings press release, the investor supplement and the 10-Q. We also issued a slide presentation that we'll be using during this call. All of these documents are available on our website. Because this is the first time we're using slide presentation in the call, we would appreciate any feedback you may have so that we can make these conversations as productive as possible for you.

On the call I'm joined by Thomas Wilson and Don Civgin, both of whom will make some comments before we go to the Q&A session. Also here are Judy Greffin, our Chief Investment Officer, Sam Pilch our Controller, and George Ruebenson, head of Allstate Protection and Allstate Financial to assist in the Q&A session.

Please note that our discussion may contain forward-looking statements regarding Allstate's operations. Actual results may differ materially. Please refer to our 2008 Form 10-K, our first quarter 2009 10-Q, and our most recent press release for information on potential risks. We will discuss some non-GAAP measures for which there are reconciliations in our press release and investor supplements.

Now I'll turn it over to Thomas Wilson for his thoughts on our progress in our quarter and if you're following along with the presentation, please turn to slide three.

Thomas Wilson

Good morning, I'll begin with an overview of our results, Robert will cover the results of our property, casualty, and Allstate financial businesses, then Don will discuss investments, liquidity and capital. As always we value our dialogue with you so we'll make sure we have plenty of time for your questions.

In summary Allstate remains financially strong despite what continues to be a tough environment. The overall themes are very similar to the fourth quarter of last year but our results were slightly better in several key areas.

We generated $454 million of operating income for the first quarter despite extremely high catastrophe losses. Our property casualty business had an underlying combined ratio of 88.9 which was in line with our full year expectations.

Allstate financial and our investment portfolio were adversely impacted by the continued difficulties in the fixed income markets which resulted in $488 million of realized capital losses in the quarter over half of which is due to noncash charges reducing the deferred tax assets.

In addition we wrote down deferred acquisition costs by $224 million due to higher expected future capital losses. As a result we had a net loss of $274 million for the quarter. Despite the challenges of a significant number of catastrophes and tumultuous investment markets, our proactive approach to risk management enabled us to be highly liquid and well capitalized.

The property casualty business had a 96.8 combined ratio which was 88.9 without catastrophes and prior year reserve releases. That was within our full year expectations, 3.1 points higher then 2008's first quarter and 2.6 points better then the fourth quarter of last year.

Allstate financial is over the halfway mark in reducing expenses to enable us to reposition this business in a different economic and investment climate. Our proactive approach in investing continues to be beneficial for shareholders. We had good gains on our equity hedges in the quarter. We lowered our real estate exposure by a billion dollars. We also lowered the duration of our portfolio by 10% or one-half a year to protect against the risk of rising interest rates despite the negative impact on operating profit.

We maintained our long credit exposure and still feel confident that this will create value for shareholders particularly given the high quality of our fixed income portfolio. We have high liquidity with over $23 billion available to cover maturing liabilities and very modest fixed charges. Our capital levels are about where they were at the end of the year with substantial resources still available at the parent company.

Let me now turn it over to Robert who will go through the two businesses.

Robert Block

Thanks Thomas, starting with property liability results for the quarter on slide four, we wrote $6.27 billion in net written premium, a decline of 3.8% compared to the first quarter of 2008 primarily reflecting a reduction in overall units.

Shopping has increased as consumers manage insurance expenditures in this difficult economy and continued competitiveness in the market limit premium development. The upside of increased shopping is the opportunity for new business growth. The downside is the pressure it places on retention.

For Allstate brand standard auto, lower retention led to a decline in net written premiums 2.4% compared to prior year. We did see a pick up in new business activity in several markets across the country but it was not enough to offset the drop in retention of four-tenths of 1%.

Retention did moderate in the quarter though staying level with the fourth quarter of 2008. Average premium also contributed positively with a small increase reflective of our disciplined pricing philosophy.

That said, contributions to premium growth through rate increases can be mitigated by consumers' actions to manage their costs by reducing their premiums through deductible changes, lower limits, or dropped coverages.

Allstate brand homeowners net written premium declined 1.2% quarter over quarter as we continued to proactively manage our exposure to catastrophic loss. As part of the all other category encompass generated the largest percentage decline in net written premium as we take significant action designed to improve profitability in this business, such as the cessation of business with unprofitable agencies, and strengthened underwriting guidelines.

Looking at the margins for property liability we recorded a combined ratio of 96.8%, and increase of 2.8 points over the first quarter 2008. The quarter was impacted negatively by winter weather and higher then expected catastrophe losses. The underlying combined ratio of 88.9% while higher then last year's first quarter was within our annual outlook and was better then the fourth quarter 2008 level.

For the quarter catastrophe losses were $516 million or $52 million less then the first quarter of 2008 but that difference needs some explanation. This year's amount included a favorable $60 million adjustment to prior year reserves associated with hurricanes Gustav and Ike, while the catastrophe losses in the first quarter of 2008 contained an adverse $117 million adjustment to hurricane Katrina losses.

So on a current year basis this quarter's cat loss of $576 million was substantially worse then last year. We experienced 14 cat events, two of which are estimated to exceed $100 million each. Please turn to slide five.

Looking at the components of loss for Allstate brand standard auto, gross frequency for both property and bodily injury increased relative to last year's first quarter. These increases were driven primarily by winter weather experienced in the eastern part of the country.

In the west frequency actually declined slightly in the first quarter 2009 compared to the first quarter 2008. This slide does show the dramatic decline experienced in the second half of last year. The combined effects of rapidly rising gas prices, lower miles driven, rising unemployment, and other factors impacted favorably the level of frequency reported.

While we still believe in the long-term downward trend in frequency the unusual results from 2008 do set up some difficult comparisons for the balance of the year. Auto paid severity results for the quarter were quite modest compared to the first quarter of 2008, bodily injury paid severity increased only 2.1% while property damage paid severity declined 2.4%. In all auto loss cost trend generally remained within pricing expectations.

Allstate brand homeowner loss trends continue to reflect pressure from both catastrophic and non-catastrophic weather events. On an ex-cat basis gross frequency rose 4.6%, while paid severity increased 3.2%. As a result the ex-cat margin rose during the quarter to 79.3%, several points above the first quarter of 2008. While this line of business is inherently volatile we must remain diligent in terms of maintaining pricing and underwriting discipline.

Quickly turning to Allstate financial on slide six, profits were better then expected due to favorable mortality results. Premiums and deposits were cut about in half this quarter reflecting the absence of any institutional markets business this quarter. Our current view of the institutional business is that it does not provide adequate risk adjusted returns.

Retail sales increased primarily due to increased deposits at Allstate Bank, and sales with immediate annuities. From a bottom line perspective we generated operating income of $85 million, down $58 million from the first quarter 2008. The decline was due to an unfavorable investment margin as we proactively maintained higher then normal levels of liquidity.

Lower asset balances yields as well as lower partnership income also contributed to the decline. The net loss for the quarter was $327 million as realized capital losses and the noncash adjustments posted in the quarter of the DAC unlock were $224 million and the deferred tax valuation allowance of $142 million offset the operating income generated.

Operationally we made significant progress on our focus to win program. We've begun to refocus sales efforts, simplifying the portfolio through the discontinuation of some products. We've eliminated several hundred positions thus far producing about 55% of the expected annual savings for the program.

We will continue along this path as we move to strategically reposition Allstate financial returning it to an acceptable level of profitability. Now let's hear from Don Civgin.

Don Civgin

Thanks Robert, I'll provide some details on our investment portfolio, how its changing, how it performed and the strong cash flows that it generates, then I'll summarize Allstate's strong capital and liquidity positions and I'll close with some details on the noncash charges during the quarter.

As the current economic crisis began to emerge in 2007 we proactively took steps to ensure the health of our portfolio through a disciplined philosophy that we termed risk mitigation and return optimization. This approach served us well in 2008 and we continue to refine it as we manage our way through these challenging markets.

If you turn to slide seven, at March 31, 2009 our investments totaled $93.9 billion, about 73% of the portfolio was invested in fixed income securities of which 94% were investment grade rated. Almost 9% of the portfolio was on short-term securities as we actively managed to a higher then normal liquidity position at the expense of generating operating income.

During the quarter we made meaningful progress toward our stated goals. We reduced our exposure to commercial real estate by $1 billion and shortened the duration of our portfolio in order to reduce exposure to rising interest rates.

That said, we will continue to maintain a significant exposure to corporate credit in order to capture the appreciation as spreads tighten. This is a good example of our effort to be transparent about those risks we are working to reduce and those that we're comfortable holding.

In an environment where no one can eliminate or even mitigate all risks, we think this transparency is important to share with our investors. Slide eight provides the last five quarters of investment income and realized capital gains and losses.

Investment income in the first quarter declined 22.9% compared to Q1 2008 after considering declining income from equities and limited partnerships, this decline was attributed about two-thirds to lower average asset balances and one-third to lower yields coupled with an intentional shift to short-term assets.

As we move forward in 2009 we will continue to assess our risk return trade off regarding our high liquidity levels. Net realized capital losses were $359 million in the quarter while still a loss, it was a better quarterly result then we've seen in previous quarters. The net loss was driven by impairment write-downs of $620 million, a result similar to the last two quarters of 2008 as well as $143 million of net losses on the valuation of limited partnerships.

Partially offsetting these losses were $418 million of gains taken on long dated treasury securities as we intentionally moved to shorten the duration of the portfolio. Unrealized capital losses grew to just over $9.4 billion. While our unrealized capital loss position continues to be significant there are several important points that cushion us from the risk this imposes.

First we intend to hold these securities to recovery, second by virtue of our highly liquid investment strategy we have reduced our risk of being forced to liquidate these assets. Frankly that's the reason we've been trading lower investment income to maintain that excess liquidity.

And third as slide nine shows, the fixed income portfolio continues to perform as expected generating almost $2.1 billion of cash in the quarter virtually in line with our expectations and contractual terms.

Turning to slide 10 as Thomas said our number one priority for 2009 is to protect Allstate's financial strength. To do so we have been intently focused on capital and liquidity. We finished the first quarter of 2009 with $12.24 billion in GAAP equity down only slightly from year end.

We have over $3.3 billion of deployable assets at the holding company level to support the insurance subsidiary's capital needs, service our debt, and pay dividends to shareholders. In addition we continue to have $1 billion of available credit facilities that remain undrawn at quarter end.

Importantly estimated statutory surplus at AIC remained level with year end 2008 and increased slightly at ALIC. Maintaining capital strength is paramount to Allstate's success and I feel good about where we ended the first quarter.

As it relates to liquidity we have stated that we will maintain the substantial liquidity position in order to meet customer needs and insulate ourselves from unanticipated asset sales. At the end of the first quarter we estimate that we could raise $23 billion within one quarter without generating significant losses.

As we continue to grow more confident with our liquidity forecasting processes and results, we will continue to assess the trade off between prudent amounts of liquidity and generating increased investment income.

Lastly on slide 11 there were two noncash charges that impacted the results for the quarter. First the valuation allowance for deferred taxes increased by $330 million of which $254 million went through the income statement. This increase was due to investment write-downs which are not currently deductible for tax purposes and increased unrealized capital losses on equity securities.

Next our annual comprehensive review of deferred policy acquisition costs and deferred sales inducement costs was completed during the quarter. The result was a charge to net income of $209 million due primarily to an assumption of increased expected realized capital losses which reduced future estimated gross profits.

With that, I'll turn it back to Thomas.

Thomas Wilson

Let me finish on slide 12 then we'll take your questions. Our three goals for 2009 reflect our expectation that the economic climate will remain difficult for this year. First we'll protect Allstate's financial strength, we'll focus on preserving auto insurance margins and reducing catastrophe risks.

Allstate financial will take the necessary steps to narrow its focus and reduce costs and we'll maintain high liquidity and reduce the duration of our fixed income portfolio despite the negative on operating income.

Secondly we need to increase customer loyalty to provide additional revenue growth. We had a small improvement in our internal measures in the first quarter but we have more work to do. Lastly we will continue to reinvent protection of retirement for the consumer by rolling out new products and services. This is consistent with our value focus and will continue to differentiate us in the competition. Now we will be happy to take your questions.

Question and Answer

Operator

(Operator Instructions) Your first question comes from the line of David Lewis - Raymond James & Associates

David Lewis
Raymond James & Associates

Couple of questions on claim severity and frequency, first on the auto side you indicated that the comps were going to be difficult relative to the favorable experience you had last year, I guess I was under the impression that unemployment probably has a greater impact then potentially the level of gas prices and given the fact that we're at the highest unemployment levels, shouldn't we see similar benefits because people commuting less during those busy travel times.

Robert Block

I think that's, unemployment does have the effect of creating lower frequency but there was such a significant dislocation in the trends last year caused by the very rapidly rising gas prices that I think consumer behavior for a short period of time changed and that impacted frequency.

So I was just making the point that last year we did experience some excellent results and our long-term view of frequency is that it will continue to decline. But on a quarter to quarter, year over year basis you never really know exactly which way its going to go.

David Lewis
Raymond James & Associates

And just to talk a little bit about the homeowner spike in the combined ratio up 2.5 percentage points, any thoughts on the severities and frequencies there, is that something that's just going to bounce around from quarter to quarter or is there some economic sensitivity potentially to those potential losses going forward.

Thomas Wilson

I would say that our homeowners business is not performing the way we'd like it to be irrespective of catastrophes and everything else so we collect premiums and we're supposed to pay out less then we take in and we did not do that this quarter.

We have work to do on that business. I think if you have questions specifically about frequency and severity George can answer them but from my standpoint we have work to do in getting that business to be more profitable.

David Lewis
Raymond James & Associates

I think we need a little more explanation on maybe why, is it just quarterly volatility, is there some economic sensitivity where fire losses are running higher currently or any thoughts on just kind of the spike in the first quarter homeowner combined ratio.

George Ruebenson

Largely the increase in frequency in the first quarter had to do with bad weather that is not categorized as catastrophes. Its very similar to what Robert was referring to as far as the increase on the east coast because of the weather. In addition to that though as we mentioned last quarter and the quarter before that with the declining economy we are seeing some increase in theft but it is not enough to actually distort much of it.

So it is really more of the weather related losses. If you adjust for the reserve changes that we took in the first quarter our cat losses in the first quarter were the worst that they've been since the Northridge earthquake in 1994. And so there is a spillover from adverse weather in the non-cat category also.

The inflationary pressure that we're seeing in severity is imbedded in our pricing models however as Thomas mentioned we're not happy with the performance that we have with the homeowner line. We're taking a harder look at the indications which as you can probably read between the lines means more rates in that line.

We are committed to make the 87 to 89 that was referenced at the beginning of the year.

Operator

Your next question comes from the line of Daniel Johnson - Citadel

Daniel Johnson
Citadel

My question, a couple please, the partnership losses, the capital gains and losses just to be clear those aren't actual losses, that's just sort of the marking to market.

Thomas Wilson

First let me just set the bar here, we have about $2.5 billion in alternative assets which is spread between private equity, real estate, and hedge funds. That's in about 294 different funds. So its highly diversified. So of course the story is different for each fund. In total if you look at the negative impact on our income statement last quarter it was about $300 million due to all of the, in various pieces.

The piece you refer to on capital losses, but also through operating income. But we believe that when you think you have a loss you mark it down. Not when you've actually experienced it months before.

Daniel Johnson
Citadel

Of the $2.5 billion how much is on the equity method, because I think that's where you would I think where you would end up taking the quarterly volatility or is all of that on the equity method.

Judy Greffin

The equity method, its about $1.4 billion on the equity method of accounting and you're right, there's a difference between the impairment losses as well as the valuation loss. So the valuation loss was $143 million and that's just the mark versus the NVA. And that's DMA. And the $197 is an impairment loss through our impairment process.

Daniel Johnson
Citadel

So if I was just trying to estimate the return on the part that gets marked, the 300 you mentioned is relative to the $1.4 billion.

Thomas Wilson

No. The 300 is for everything. There was two parts, there's the impairment which is all stuff and then there's the part that's just on—

Judy Greffin

--DMA which is the versus the NVA and they didn't meet our requirements for impairment.

Daniel Johnson
Citadel

A couple of companies have mentioned their life insurance capital position at the end of 2009 under a bunch of different scenarios, but one thing that many have mentioned is they're assuming that they will not have the benefit of the permitted practices that were given whatever, a couple of months ago, what's your view on that.

Thomas Wilson

First, I think the question on permitted practices is do you account for it in a way that's fair and equitable relative to the risks and opportunities that you have and our view is that the change was actually more reflective of what the true economics of it are.

So sometimes people say, well its changed so it must have been some special deal. It had nothing to do with a special deal, it had with doing it right. There are, some of it depends whether you hold these assets in a general account or in separate accounts and there's really not a whole lot of difference from an economic perspective for us as in total company.

And so if the practice is to change, we could hold it in a different way which we think would mitigate any impact on the change.

Daniel Johnson
Citadel

So you're not anticipating the permitted practice will disappear and if it did you could offset some of it.

Thomas Wilson

Yes, I don't, we don't project what the permitted practices will be. I'm just saying that from our standpoint we think its right the way it is. If it was to change, and it may change, we will change the way in which we hold those assets so that we think our statutory capital accurately reflects the risk we have.

Daniel Johnson
Citadel

Of the billion dollars of commercial mortgage reduction can you split that between I think you'd mentioned sales and just the sort of normal receipt of or the normal pay downs or conclusions of those mortgages, can you help split that out.

Judy Greffin

On the commercial mortgage, on overall commercial real estate we said that we reduced it by a little over a billion and within that was $533 million of commercial mortgages. And within that we sold a little over $100 million and then we had a small write-down of $34 million and then on the balance were collections.

And what we found was that in the quarter we actually got pay offs earlier then what we expected for the year so some of those pay offs are showing up earlier in the year and some of them are actually showing up earlier then, for mortgages that aren't even due this year yet.

Operator

Your next question comes from the line of Jay Gelb - Barclays Capital

Jay Gelb
Barclays Capital

My first question has to do with Allstate's capital position, I noticed on the slide you put up where the GAAP and statutory capital positions are in the first quarter versus the year end and they're pretty much stable. My question is if Allstate's capital positions both on GAAP and stat equity are lower at the end of 2009 versus where they are in 2008, does Allstate need to raise capital.

Thomas Wilson

It obviously would depend how much lower. But let me say that we think we have additional capital, what we would call deployable capital, which is over and above that required to either from a rating agency, regulatory or economic perspective would be capital we could use for other things. We felt we had deployable capital at the end of the year. We think we have deployable capital at the end of this quarter and then the question would be how much it changes.

But we think we're in good shape.

Jay Gelb
Barclays Capital

How much of a cushion do you feel you have currently.

Thomas Wilson

We don't give that number out.

Jay Gelb
Barclays Capital

Second point is on the investment income line, it was around $1.2 billion in the quarter and almost 25% of the portfolio now being in cash and highly liquid securities what do you feel is a reasonable run rate for that going forward.

Thomas Wilson

I'm not going to give you a run rate since we've been trying to move away from guidance and earnings projections and we said the thing we can and do commit to is combined ratio which as George said we're sticking with our 87 to 89. Obviously that number will bounce around a little bit particularly in this kind of environment.

I can tell you what we're looking at doing, which is we are looking to deploy some of those short-term assets into higher yielding assets so if you look at the quarter we bought a number of FDIC guaranteed bonds, I think a couple billion dollars worth, because we like the yield on them and we thought they were a good solid crutch and we had extra liquidity.

We will probably continue to deploy some of that liquidity into high grade readily salable but higher yielding securities which should put upward pressure on that. At the same time we are seeking to reduce our interest rate exposure because we believe there's a greater chance that interest rates will go up then go down and the benefit we've realized inside our portfolio in the last two years, in both 2007 and 2008 from declining interest rates we don't want to give that back.

So we are shortening the duration of our portfolio which is why we sold the government's and took $418 million of gains in the first quarter. It wasn't because we wanted the gains, we just didn't want the interest rate exposure because those were nine and 10 year maturity bonds and they had good rates on them.

So we thought they were over priced relative to the future value of them so we sold those. That will obviously put a little downward pressure on investment income. At the same time we're continuing to maintain our credit exposure. We like credit exposure, its been a good bet for us this year. It obviously was not a good bet for us last year but we're thinking rates will come in, spreads will come in and that will be beneficial to us so we're looking to deploy more of our assets into, and maintaining or potentially increasing our credit exposure which would put an upward drift on investment income.

So I can't give you an exact number but I can tell you that we're managing the portfolio for both the economics in the environment we have rather then just letting it sit there and hoping everything gets better.

Jay Gelb
Barclays Capital

With the new applications up on standard auto but the [pip] down, do you feel that you're priced competitively enough on the standard auto say versus some of the direct writers.

George Ruebenson

The uptick in new business is very encouraging for us. It's the first time in many quarters that we've actually shown growth in the new business side. One of the problems that we have is that over the last several years we've been declining and so the way the math works is what's available to renew has dropped which will be hard for us to show quarter over quarter unit growth for a short period of time.

As far as our price competitiveness, yes we believe that we are. The thing is its very difficult to say, are you competitive with Geico and Progressive, I'm assuming that's what the question is. In specific places we find that we are able to take business from both of those so we believe that our price competitive position is pretty good.

In addition to that though we don't believe that the product is a commodity which is what the two of them do promote. They talk about price only. We believe that the value proposition that we offer is enough for a lot of people to join us which is why we're starting to see some new business growth.

In addition remember we have 25 million customers. We have 11% of the market. Progressive declined in market share over the last two years while we held. Geico has grown but I'm starting to see that they are opening store fronts. This morning as a matter of fact I heard about a Geico agent that had an add on the radio. I don't know if they're seeing some kind of diminization of their ability to penetrate with just that model.

I don't know. But I do know that they have 7% of the market and we have vast opportunity to grow despite the fact that they're making inroads.

Thomas Wilson

Let me make a couple of more general comments too, a decade ago we made the commitment to sell both through our own captive agencies and the 30,000 people who live in those local offices and provide local service. We sell direct over the phone through our own call centers and over the web and through independent agencies.

And so we compete across the broad breadth of distribution vehicles and have cost structures comparable to other people in those. When you look at our price position versus Geico, I think you'd see we are about, sometimes we beat them, sometimes we lose [inaudible]. I think what George says is completely accurate.

If you look at the overall price environment we've been in the, I would call it slow and steady camp, which is we take increases, raise prices when we think we need to, when we don't need to. And if you look at our average premium its been kind of flat basically. If you look at what's happened in the industry, this is now the sixth quarter in a row where there have been more increases then decreases by our competitors in total and that includes all the big carriers you were talking about.

And most of those are in the camp of sort of three to one, three increases for every decrease. So we feel like our competitive position and long-term position that George talked about makes sense. You do see increased focus on price today from a marketing standpoint. Currently obviously in this environment that's obviously and issue, so you've seen we've changed some of our marketing so we have a higher affordability and we've made good progress on people on our relative perception of our price position would be the way that I would describe it.

Our price position is what it was and is what it is and getting better as people raise prices, but, so we feel okay about where we're at but its sort of we have a long-term view to this rather then jacking prices up or down or going for the big increase in one particular quarter.

Operator

Your next question comes from the line of Ian Gutterman - Adage Capital

Ian Gutterman
Adage Capital

I just wanted to follow-up on that on the new business, can you make characterization of what kind of customer type that new business has been driven by, is it across the board or is it more spiked to the value type areas.

George Ruebenson

Generally we still sample pretty well across the board. We have seen a migration to people taking the lower priced options within our your choice auto portfolio. When we first introduced your choice auto four or five years ago the market obviously was much more robust then it is now and a lot of our customers were migrating to the platinum.

We're seeing more people go to the value or the silver, the lower priced one. In addition we introduced a product called money saver in Ohio a couple of months ago. Its about 10% lower then the value product and we're seeing pretty good acceptance by the market there. What we're also seeing though is that by virtue of the fact that people are not buying additional cars, its difficult for us to grow its add cars, as the fleet starts to regenerate itself you'll get normal rate increases.

But as far as the shopping of the public, we're seeing it across the board and we're doing pretty well. Now what we've decided though is that we want to accentuate our attention to the what we call the high lifetime value customers, those are multi car customers with a homeowners. We're looking at increasing in the third and fourth quarter substantially increasing the discounts that we give to those customers on both the new business basis to attract more but also on a renewal basis so that we can increase the retention that Robert alluded to in his opening comments.

Ian Gutterman
Adage Capital

And what would be a price difference like between a value and a platinum roughly.

George Ruebenson

I thinks it 20 when you go from value to platinum. It goes from bottom to top, I believe its about 20% and what we do though, and just to be clear, each of those products is priced to the correct margin. Its not like where you have new business on sale, on any of those, so if people migrate down, we might not get the premium development but it does not have any adverse impact whatsoever on the combined ratio.

Ian Gutterman
Adage Capital

I was thinking more about on top line, I guess what I was wondering is, is on the places where you're seeing, where you're losing some retention are those coming out of the platinum customers and the new customers are coming in at silver and value so even if you have flat [tiff] you might have some pressure on premium dollars.

George Ruebenson

Yes we are, we are seeing people within our portfolio though staying with Allstate, opting to go from platinum down to value. So endorsements are up considerably in the value product. In addition I mentioned this I know in the last quarter is that people are going to higher deductibles and dropping some coverages. So there will be pressure on top line for average premium development.

But again because car sales are down 40%, what you're not seeing is the normal development of premium that you get when new cars are added to the fleet.

Operator

Your next question comes from the line of David Small - JPMorgan

David Small
JPMorgan

If you look at the statistics it looks like overall for the industry that the cap of agencies overall continue to lose share, do you think that you need to rethink about how you sell your product, put more focus on other channels in order to restart growth at Allstate.

Thomas Wilson

We sell through both our own captive agencies. We sell through independent agencies and we sell through direct. Our direct business generates a reasonable proportion of our new business for us. It's a growing business. We have that fully integrated though with our agencies. So we might bring them in through an internet sale or bring them in through a call center sale and then they might hook up with our local agencies and they sell them other products. They give them local service.

So we don't break it out by channel because we think the right way to think about it is by customer and they can come to us any way they want. So we think we have all the tools and we're active in competing in all those ways. So if you want to call us and buy over the telephone you can do that and we sell a number of policies each and every day that way.

And you can call a local office and buy it over the phone which is a mini call center. Or you can call a big call center which is comparable with Geico's. So we're competing across all those fronts already.

David Small
JPMorgan

Is there anything different you think you need to do in order to get the growth moving upwards.

Thomas Wilson

Well obviously, we'd always, new things we'd like to do differently. The biggest thing is we need to raise our customer loyalty which is our second goal which is retention. Our retention was flat this quarter versus last quarter. But it was down from this point last year. Some of that we can write off to sort of the competitive environment, people trying to shop more and that kind of stuff, so you see our new business up.

But we still need to improve our customer loyalty. Customer loyalty is a measure, current customer satisfaction and intent to renew and willingness to refer to others. We have a series of programs all across the company that go everywhere from products like your choice auto to call back programs to incentive programs where its now customer loyalty is the measure under which we put additional money into our employees' 401K. That's not profit its customer loyalty.

As well as a greater accountability and different standards throughout the company so George and his team are pushing hard on that. We've made some progress in the first quarter. We have more progress to go. That is the fastest way for us to grow rather then going out and cutting prices, giving up margin, when we provide a good value as it is.

Operator

Your next question comes from the line of Alison Jacobowitz - Banc of America-Merrill Lynch

Alison Jacobowitz
Banc of America-Merrill Lynch

I was wondering if you can give us an update on California auto and I think with everything you said, I don't think I really heard it, can you talk some about what impact the economy might be having on claiming behavior other then the miles driven, are you seeing any changes there.

George Ruebenson

With regard to California auto I think you're aware that we had a mandated rate decrease the middle of last year. We are trying to secure some rate increases there but the overall effect has been that we are growing new business in California considerably. We are still comfortable with the margins on that business.

Your second question having to do with claiming behavior, I believe, could you repeat it please.

Alison Jacobowitz
Banc of America-Merrill Lynch

What the economy might be doing toward claiming behavior other then the less miles driven and everything else you've already talked about, are you seeing anything else going on in claims.

George Ruebenson

Yes, when unemployment rises typically we see an increase in thefts. We are seeing it in both thefts of auto and homeowner thefts. We have about a 15% increase in special investigative unit referrals. These are suspected fraud. It's a fairly common thing that again happens in this type of economy. We are taking many proactive approaches to it where we think that there is a [blighted] area for example where there's homes that are going into foreclosure.

We send people out to make sure that the home is indeed occupied. If its not occupied then we have the ability to cancel it immediately. We are being very careful on the type of new business that we're taking so we're not just watching the economy create some issues for us. We're actually trying to get ahead of the curve.

But again we've done this before and it is not putting significant pressure on us but it does impact claiming behavior, yes.

Operator

Your next question comes from the line of Unspecified Analyst - Perry Capital

Unspecified Analyst
Perry Capital

Can you help us understand how we should think about downgrades to fixed income securities in your investment portfolio and I'm thinking specifically of the structured products.

Thomas Wilson

Is that structured products in total or structured, is there a particular category structure.

Unspecified Analyst
Perry Capital

Well the downgrades to RMBS have been coming for several months now and it looks like CMBS securities have just started being downgraded by some of the rating agencies, so I'm just wondering how we should think about that in the context of your risk based capital requirement.

Thomas Wilson

In the investor supplement we do break out by security type the credit rating of the various things and you will see that the RMBS securities, you're right have had a lot more downgrades on them then CMBS, but also CMBS you'll see we own a much more AAA stuff.

Judy Greffin

You're right the structured products are beginning to see a lot more downgrades from the rating agencies as they do their work and they go through and we've seen quite a bit in RMBS, we've seen some in the CLO CDO portfolio as well as in CMBS but we think that they're still doing their work across the board.

So we will be impacted by the downgrades. We have been impacted by the downgrades. We look at our portfolio from a fundamental perspective still and do our own work around the portfolio taking into consideration certainly the impact of the downgrades have on RBC, but also doing our own work, stressing the portfolio in the structured assets and you can see that the impairments this quarter on the structured portfolio were not that great.

Unspecified Analyst
Perry Capital

I'm just trying to wonder how to think about the RBC ratio in ALIC now if you're still near the 300% target given that statutory surplus was up versus last quarter however I imagine that the risk based capital charges primarily because of downgrades is going to be up a bit.

Thomas Wilson

We feel alright about our capital position at Allstate financial. Under Illinois law we're not really allowed to talk about what the RBC ratio is either what it is today or what its targeted at just Illinois Insurance Law. You can get off a variety of stuff. We feel pretty good about where we're at. We obviously look, we do capital forecasting looking forward so we don't just sort of say how did we do at the end of March, we look forward a quarter, we look forward a year.

And the ratings drift I think is what you're after. We obviously factor into everything we do and we have asset allocation guidelines and limits as to how much we want to have in different rating categories and so and we make adjustments for that. So for example, if you look at our total portfolio, the entire company, and you looked at the below investment grade securities you would see they totaled to about $4 billion and you would see that a year ago they totaled to about $4 billion.

There's obviously many different securities in there and we buy and sell stuff and if we think its going to get downgraded and as Judy said if we think it's a good trade, and its headed down, we sell it. If we think it's a bad trade and its headed down, we might sell something else.

So we're constantly managing both the economics of our portfolio and its impact that it has on statutory capital.

Unspecified Analyst
Perry Capital

Given that the final $250 million capital contribution from AIC to the life co was made this quarter what sort of ability do you have [perspectively] to dividend capital from AIC to the life co.

Thomas Wilson

We don't have the dividend adjust from AIC to the life co because we have capital at the parent company so there's plenty of places we can get money and we think as Don said earlier we have plenty of capital both at the individual subsidiary levels and at the parent company. So it doesn't have to just come from one place. We have $3.3 billion of assets which are unencumbered at the parent company which we could push wherever we would choose to push that.

Operator

Your next question comes from the line of Matthew Heimermann - JPMorgan

Matthew Heimermann
JPMorgan

I wanted to just follow-up on just the preferred portion of your customer base but how much of the retention, well actually here's the question, with homeowners decreasing I would assume cross sold homeowners auto is a high percentage of the preferred portfolio, how much of that is actually driving kind of the auto retention, if it is at all.

Thomas Wilson

First you'll see homeowners retention is actually up and so which is because we think we're well priced. We provide good claim service, that kind of stuff, there's lots of reasons. George may have the percentage on cross sells, I don't know how much that would give out. I would tell you that in the places over time where we've substantially reduced our homeowners book, we've maintained our market share in auto.

So for example, in Florida we used to have a double-digit market share in homeowners. Today we are down below 3% yet our auto share has actually gone up. So we've been able to, and we haven't changed our focus so obviously some of those customers we don't sell homeowners to but we broker homeowners business to them.

So it hasn't, the catastrophe management programs haven't decimated our auto business. There's obviously some challenges for you when you call somebody and they've been your customer for 10 years and say, I'm not going to ensure your home anymore and company X is available to do it. It doesn't exactly make them say, geez that's the best thing ever happened to me.

On the other hand we have managed to get through that because we have good prices, good products, good relationships and have served them well.

George Ruebenson

The other thing is that the vast majority of the very draconian actions that we've had to take to reduce PML are actually behind us. We're still non renewing in certain places, Long Island specifically. We are pushing more to win pools going to higher deductibles so if you look at what we have to do in the future and the impact that's going to have on cross line sales, we have less to do now then we did two years ago.

The other thing though is that when we did non renew all of these customers we allowed our agents to broker that homeowner business to another carrier. That was very successful in allowing our agencies to keep the customers. So it hasn't really been a big problem for us.

Matthew Heimermann
JPMorgan

You said retention was up based on the stats you gave it looked like sequentially the retention was down modestly, and tiff fell by about a percent, in homeowners.

Don Civgin

First quarter 2009 versus first quarter 2008 homeowner retention is up.

Thomas Wilson

It bounces around a little bit, I mean, you're talking about fourth quarter 2008.

Matthew Heimermann
JPMorgan

Yes I was looking sequentially. I just wanted to make sure.

Thomas Wilson

Some of that is related to when the policy terms are. A lot of people buy houses in different periods so the terms, but anyway.

Matthew Heimermann
JPMorgan

I just wanted to make sure that I wasn't completely missing something. The other question I had was just can, with respect to the DAC assets still on the balance sheet can you talk about what kind of the testing will be with respect to how long you can hold that, I mean clearly I believe if you mark your investment portfolio up some of that will start to come down, but let's just say markets don't change, how long can you actually hold that on the books.

Don Civgin

We completed the annual unlock here in the first quarter and we will continue to look at it going forward. We look at a variety of different things so we'll look at investment returns, gains, losses, expectations of those things, crediting rates and so forth. And there's really no answer to the question how long can it stay. I think so long as the profitability of the products that the DAC is related to continues to be maintained, it will amortize under the schedule you would expect as the assets wind down.

Thomas Wilson

I would say relative to some other companies, remember we sold our VA business in 2006 and so when you look at the underlying assets that generate the profitability that Don talked about, they're not as volatile as assets that underlie a variable annuity in terms of their ability to generate income for you.

Matthew Heimermann
JPMorgan

And then with respect to that duration, and I guess that will be the, I guess that's probably the proxy for the life then is the duration associated with that DAC, should we think about that being longer or shorter relative to the duration of your portfolio.

Thomas Wilson

First a lot of time we write the DAC off not necessarily related to the duration of the investments underlying it but related to the duration of the liability. So we look at the surrender charge and if it has a surrender charge of five or seven years you'd like to have most of your DAC written off by the time you get to the end of that surrender charge because its really the liability that drives, the existence of the liability that drives your ability to make profit as opposed to the underlying asset.

So changing the duration on the portfolio could have the impact of lowering your future expected returns, because you don't think you're going to make as much money and that is part of what caused the write-down in the first quarter was we just looked forward and said, we don't think we're going to make as much money on our investment, therefore the total profit we're going to make over the life of these liabilities is down, therefore we need to write off some of the deferred charges we incurred for selling those products.

Operator

Your next question comes from the line of Brian Meredith - UBS

Brian Meredith
UBS

Just on the reinsurance purchasing you mentioned that you may need to purchase some additional reinsurance, the $2 billion of tick away or does actually go away, I guess any intentions to actually replace some of the [Willow Reece, North East] cover as well as you look at the [tickle layer] any thoughts on buying additional cover there just to protect against nonpayment risk.

Thomas Wilson

You're talking about, first we're into Allstate Floridian, and the tickle layer is the, it's the stuff, I know where its from I just want to make sure everybody else knows where its from which is the upper level of reinsurance provided by the state to companies like Allstate Floridian which is a separately capitalized company and the question that is around in the industry today is will it be available and actually is it financially reinsurance because there's not a whole lot of financial capacity behind that.

With that background George, maybe you want to answer what you're doing there.

George Ruebenson

Thomas mentioned that several years ago we had a 10% market share and we're down to around 3%. Its still our intent to reduce our exposure in Floridian. Its also our intent not to give more money from the parent to the Floridian company. We are in the market looking for protection that we need to maintain the viability of our company there but I don't know personally whether the tickle layer will be there or not we want to protect ourselves.

The specifics and what we're going to do with Willow Reece, that hasn't been decided.

Thomas Wilson

Willow Reece is small, its 5%.

Brian Meredith
UBS

You've positioned the portfolio right now for higher interest rates and obviously the thought of inflation potentially going forward, how do you protect your actual severity, your auto book from potential inflation here coming forward other then I guess just price which would be reactionary.

Thomas Wilson

Obviously price is, you should charge people what you think the costs are going to be for the services or things you're going to fix for them are. And we obviously do that but I would say the bigger thing is the work that George started on four or five years ago when he was running claims and I was back at Allstate protection which was we could see that we were headed, we had the risk of going from a potentially benign inflationary environment in cost to a more, an environment like you described with rapidly increasing costs.

So that was why we put next gen claims in and we spent the better part of four plus years and last year was really the year in which we finalized the massive part of the implementation. You're always making these things better and doing new things to them but it was a massive change effort really over the last two or three years operationally.

And we think that is what has positioned us to use the data that we get, we've changed processes, we can settle claims faster, we have much greater visibility into that which we do which we think positions us well if inflation takes off.

So in addition to, the answer is though you want to pay what's right. You don't want to pay too little, you don't want to pay too much. You want to pay just right and in an inflationary environment you would have to pay more but given the way we do pricing and the way we've been into the frequently adjust, always be there, don't get behind on it, we don't think we're at great risk there.

George Ruebenson

And if you look at what our results are for the first quarter our PD severity was actually down, last year it was very moderate. We keep track of all this with a lot of lead indicators as far as the price of goods that we have to purchase. In addition a lot of it has to do with the labor rates that we get in the body shops. We have 4,000 pro shops preferred body shops, where we have a lot to say as far as what our ability to settle claims is.

If you look at our history we have always outperformed on both auto and homeowners relative to the industry so we feel pretty comfortable where we are.

Operator

Your next question comes from the line of Robert Glasspiegel - Langen McAlenney

Robert Glasspiegel
Langen McAlenney

George, you’ve been holding on to the interim position for five months, I guess at what point does that become a permanent position.

Thomas Wilson

We’re out actively looking for a new head of Allstate financial. George is just working overtime these days.

Robert Glasspiegel
Langen McAlenney

Have we made a definitive decision that we want to maintain our position as a manufacturer of life insurance products. I understand the strategic need of maintaining distribution to your customer side, but if we look at the historic returns in this business as reported they never really got to your target and if we put the all in charges to what this has done to your balance sheet as far as straining you and not allowing you to buyback stock what I’m sure you think is very attractive levels, it looks like whatever arrow we target that you had historically was probably even too low. If you want to stay a manufacturer of this product, it seems like you should be shooting for high teens type returns. Have you made the definitive decision to continue manufacturing life products.

Thomas Wilson

Thank you for the feedback. We’re anxiously waiting for you to put aggressive buy on us so our stock will be higher and then we won’t feel as badly about not buying it all back. In terms of our life business really you have two components, you specifically said life products as opposed to life and retirement products. Obviously the current turmoil and meltdown in the marketplace has destroyed many economic models and businesses that people thought were attractive.

Clearly writing as many fixed annuities as we did was not a good proposition for our shareholders. We backed off that about three years ago. If you look a the sales that we’ve had on fixed annuities over the last couple of years, it has been steadily down. I wish I would have backed off faster and harder.

That said, I look at our customer base and I think they will need a place to save that is stable in retirement. It might not be fixed annuities as currently done, but we have the skills and capabilities to take a shot at can we create a new model in that business which generates good returns.

In the life business it has generated good stable returns. It continues to generate good stable returns and we feel good about that particular business. So I think it is a question of how can we reinvent, we have said we’re not wedded to having to make everything. So if you look at what we did with variable annuities in 2006 we said we didn’t like the risk return trade off so we sold that business and we got like $600 million for it. We’d be writing a check for somebody for a giant number today if we still had that business.

I didn’t know it was as good a trade as it was. If it was I probably would have made it sooner. But the point is we’re not wedded to having to do anything. We manufacture if we think we can make money at it and it’s a good return for our shareholders, if we don’t, we don’t. And we do the same thing in the property casualty businesses George was talking earlier about homeowners in Florida.

Robert Glasspiegel
Langen McAlenney

Thank you for the thoughtful answer and by the way a definitive vote for your new format and disclosure and timing, I appreciate it.

Operator

Your final question comes from the line of Joshua Shanker - Citigroup

Joshua Shanker
Citigroup

In the prepared remarks and in the press release you stated that your internal measures of customer loyalty are up, given that retention is down, how do those two things, can we talk about what those internal measures are.

Thomas Wilson

The internal measures, we obviously go out and sample our customers. We do measures all the way down to the front line employee in claims and the same thing with our agencies. We have an agency loyalty index and we do all kinds of sampling on that. Our numbers are up. You might say well geez why is your loyalty up and your retention down, first I would say one quarter does not a change in consumer behavior make.

Second I would say that you have very competitive, people are shopping around a lot more now which is why you see more new business and so what would it have been had customer loyalty not go up is an imponderable. All I know is if we make them happy, if we want them to renew and if they'll tell their friends about us we will have more stay with us. We've made some progress but I don't want you to think I feel like we've cracked a code on that one yet. We still have more work to do. We're working very hard on it. Its something George is on top of daily.

And so in the long-term that will drive I believe higher retention which will drive higher growth. You move that retention number by a point, that's a point of growth that pays off forever.

Joshua Shanker
Citigroup

Any ballpark answer to this question, what percentage of the OTTI marks you took in 2008 were related to interest rate movements and what percent were related to credit problems.

Thomas Wilson

I'm not sure I could tell you the difference—

Joshua Shanker
Citigroup

I'm talking you're going to be implementing FAS 115-2 in the coming quarter, I'm sure you've done some work on it, what do you think the outcome is in terms of the add back to retained earnings.

Thomas Wilson

That's a question behind a question.

Don Civgin

We are going to implement 157 and 115 in the second quarter but we're still working through those calculations.

Joshua Shanker
Citigroup

No preliminary remarks then I take it.

Don Civgin

No.

Operator

There are no additional questions at this time; I would like to turn it back over to management for any additional or closing comments.

Thomas Wilson

Let me close up with a couple of thoughts, first 2009 saw a really a continuation of what we had throughout last year which was a difficult operating environment. The economy is obviously unsettled, financial markets are tough, weather was tough for us. That said, our proactive approach continues to serve us well.

We will keep the focus on operational excellence, customer focus, enterprise risk management and capital strength that's worked well for us, that will continue to be the things we focus on. Allstate protection did post an underwriting profit for the quarter with an underlying combined ratio that was within our annual outlook and we do need to generate profitable growth.

We are focused on it but we're not going to give up profits to be able to do that. Allstate financial did take steps to getting a more flexible cost structure but we have more work to do there as well. In investments, actively manage our asset allocation by reducing our exposure to commercial real estate and rising interest rates and we do want to make sure everybody understands we are strategically positioned to benefit from credit spreads and we continue to take that risk.

And the portfolio continues to generate a lot of cash flow. As Don talked about, over $2.1 billion of cash flow which was what we expected. We remain highly liquid which gives us the flexibility to hold assets that are in an unrealized position so we can get them to recovery. And that as Judy likes to call it pull to par, rather then being forced to sell assets into illiquid markets.

And lastly our capital position remains solid both on a GAAP and a statutory basis. So we remain focused on our three priorities for the year, keeping Allstate strong financially, improving customer loyalty, and reinventing protection retirement for consumers.
Thank you for you interest in Allstate and we'll see you next quarter.