S&P Capital IQ

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The Allstate Corporation NYSE:ALL

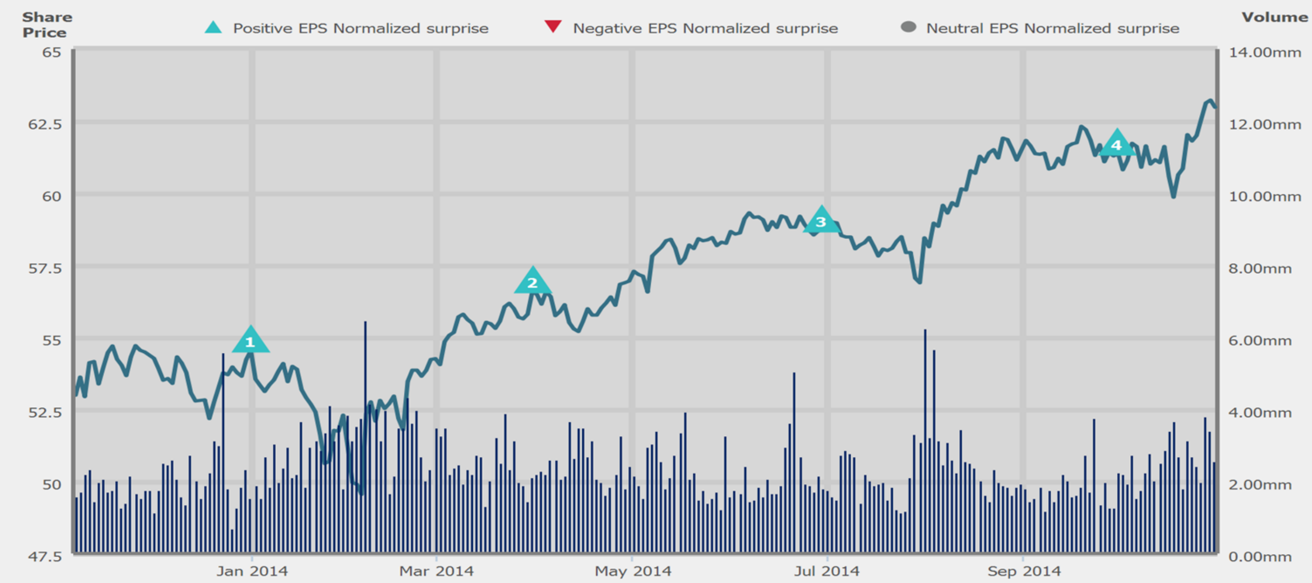
FQ4 2014 Earnings Call Transcripts

Thursday, February 05, 2015 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2014-			-FQ1 2015-	-FY 2014-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	
EPS Normalized	1.68	1.72	2.38	1.45	5.32	5.40	
Revenue (mm)	7370.00	7354.00	(0.22 %)	7466.65	29018.00	28929.00	

Currency: USD
Consensus as of Feb-05-2015 12:41 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2013	1.37	1.70	1 24.09 %
FQ1 2014	1.18	1.30	2 10.17 %
FQ2 2014	0.68	1.01	3 48.53 %
FQ3 2014	1.32	1.39	4 5.30 %

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Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Allstate Fourth 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, Pat Macellaro. Please go ahead.

Patrick Macellaro

Thanks, Jonathan. Good morning, everyone, and thank you for joining us today for Allstate's Fourth Quarter 2014 Earnings Conference Call. After prepared remarks by Tom Wilson, Steve Shebik and myself, we'll have a question-and-answer session. Yesterday, we issued our news release and investor supplement 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 in our investor supplement.

We're recording the 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.

Now I'll turn it over to Tom.

Thomas J. Wilson
Chairman & CEO

Well, good morning. Thank you for your continued interest and investment in Allstate. I'll provide an overview of where we stand strategically and operationally, and then Pat and Steve will go through the results in detail. And as always, our senior leadership team is here with us, so Matt Winter, who's Allstate's President and the leader of all the Allstate branded operations; Don Civgin, the President of Emerging Businesses; Kathy Mabe, who's President of our Business to Business Operations; Judy Greffin, our Chief Investment Officer; and then Sam Pilch, our Corporate Controller.

Let's start with Page -- Slide 2, Allstate's 2014 results. It demonstrates that our consumer-focused strategy when combined with strong execution creates real value for shareholders. We had 5 operating priorities for 2014. Let me go through each of those with you, starting with growth.

We had a good year with total policies in force growing by 840,000 or 2.5%. The Allstate brand had accelerating growth throughout the year as auto insurance built up momentum, and we've put increased focus on growing the homeowners business now that we're comfortable with its returns. The number of Allstate agencies increased by 4% for the year, and auto new business in 2014 hit a historical high. When combined with improving customer satisfaction and retention, that's leading to sustainable growth. We intentionally slowed growth at Esurance and Encompass to focus on improving returns.

The second priority was to maintain margins, and we did this through the year with the underlying combined ratio being at the favorable end of the range we set at the beginning the year with you. Fourth quarter auto margins were off somewhat, and Pat will discuss that in a few minutes. The Allstate brand homeowners business had a great quarter with recorded combined ratio of below 70. Despite a 42% increase in catastrophe losses from the prior year, the combined ratio for this line and this brand was 82.5 for the full year, which results in a good long-term return on capital. Esurance's underlying combined ratio improved by 1 point for the year, and Encompass' average premiums were up, and frequency was down, but that's yet to translate into a lower combined ratio.

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You can also see the benefits this year of having a broad product portfolio on profitable growth, both on the upside in terms of growth and then balancing out our returns. The homeowners business now generates strong returns as do many of our other non-auto insurance products. Proactively managing our investment portfolio is also obviously required to generate good economic results for our shareholders. Our total return on the $81 billion portfolio was 5.80% for the year, which is a strong result given the large position in investment-grade corporate debt. We have maintained a shorter duration in the Property-Liability portfolio, which is focused on the 3- to 5-year portion of the curve because the return per unit of risk for going longer did not meet our objectives.

We also made good progress of being more active in leveraging our position in buying and selling fixed income securities, so if you look at the 10-K, you'll see that our portfolio turnover is up a little bit there. In addition, allocations to investments with less correlation to public markets such as private equity, infrastructure, real estate, continue to be increasing.

The last 2 priorities are longer term and include modernizing the operating model and building long-term growth platforms. The integration of data analytics and technology are enabling us to improve both the effectiveness and then the efficiency of -- throughout the company. Allstate Financial did a good job of reducing expenses given the reduced size of the business following the sale of Lincoln Benefit. We're now positioned to increase investments to further integrate this into the Allstate Agency channel with a customer focus.

Esurance is a good growth platform for us, and we're increasing market share in that self-serve and branded customer segment through incremental marketing investments and by expanding into homeowners and other insurance lines and entering some new geographic markets. We're also investing heavily in telematics in growing our online aggregator Answer Financial.

Go to Slide 3. The financial results for the fourth quarter and the full year are shown on this slide. Growth momentum continued. We increased net written premium by $1.4 billion this year or 5.1%, which reflects the policy in force growth and an increase in average premiums. Let me put this in perspective. That growth alone would be enough to rank us a top 25 personal lines carrier.

Our financial results for the year were excellent. Net income was -- for the year was $2.7 billion. It was significantly higher than last year, but you remember last year, we recorded the initial estimated loss on the sale of Lincoln Benefit in 2013 results. Operating income was $5.40 a share, $5.40, which includes an increase of $742 million in pretax catastrophe losses compared with what was a relatively benign 2013.

Capital management and shareholder returns are also priorities that did not change from year-to-year, and we had excellent results in those as well. Shareholders received $2.8 billion in cash, which represents almost 11% of our average market capitalization for the year. We also just raised the dividend by 7% and announced yesterday a new $3 billion share repurchase program. We further increased our financial strength by taking advantage of the opportunity to issue preferred stock at fixed rates and lower the debt-to-capital ratio to below 19%.

Slide 4 then shows the full year operating results under the way in which we construct the market, so that's the 4 Property-Liability customer segments. This slide, we talked about every quarter for a while. If you start at the top of the slide, in aggregate, profitability was strong with a recorded combined ratio of 93.9, which included 6.9 points of catastrophe losses. The underlying combined ratio for the year that excludes catastrophes and reserve changes was 87.2, which was at the favorable end of the outlook of 87 to 89 provided for 2014.

The Property-Liability results by customer segment are shown on the bottom half of this page. If you start in the lower left, the Allstate brand is our largest segment. It comprises over 90% of our property liability written premiums. Profitability in this segment was good across all products in 2014, and growth accelerated throughout the year. Auto policy growth of 2.9% versus the prior year was broad based and driven by strong new business results and stable retention. Homeowner policies grew 0.5 point so -- over the prior year, and other personal lines policies were 2.1% higher than the year-end 2013.

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Esurance in the lower right grew policies in force by 12.6% over the prior year. Our growth rate there was impacted by profit improvement actions and the growing size of the business. Advertising and expansion investments continue to have a negative impact on the recorded combined ratio, so therefore, we look at the underlying loss ratio, which, of course, excludes expenses, which removes the -- and then you look at catastrophes and prior reserve changes come out of that as well, and that was 76.6 of the full year, a full point better than 2013.

While the returns on new business are above our cost of capital, we believe we can do better. So growth has been slowed, but we're still working on increasing market share.

Encompass, in the upper left,, further slowed growth in 2014 as we expanded our profit improvement actions. This business is highly focused on lowering the underlying combined ratio in both auto and homeowners in 2015.

Answer Financial, on the upper right, is an insurance aggregator and sells nonproprietary policies through the web and call centers to self-serve customers. Nonproprietary premiums of $527 million in 2014 increased over 10% versus the prior year.

Go to Slide 5. I'd like to look forward before we dig deeper into the current results. On Slide 5, you can see there are 5 operating priorities for 2015, which are the same as they were for this year. The specifics under each of those, obviously, are evolving based on the progress we've made this year, but the overall categories are the same. We're also not changing our underlying combined ratio guidance from 87 to 89. That's the same in 2015 as it was in 2014.

Now let me turn it over to Pat.

Patrick Macellaro

Thanks, Tom. I'll begin by reviewing the Property-Liability highlights on Slide 6. Beginning with the chart on the top of this page, Property-Liability earned premium of $28.9 billion in 2014 grew $1.3 billion or 4.7% over 2013. Recorded combined ratio for the year of 93.9 increased 1.9 points versus 2013 driven by an increase in catastrophe losses of $742 million or 59.3% compared to the historically low level recorded in 2013. As Tom mentioned earlier, the year-to-date underlying combined ratio was an 87.2, at the lower end of our full year outlook range. Net investment income for the Property-Liability segment decreased 5.4% from the prior year due primarily to lower returns from the fixed income portfolio. Property-Liability operating income in 2014 was $2.1 billion, 16% lower than 2013, reflecting the higher catastrophe losses.

Chart on the lower left shows net written premium and policy in force growth rates for Allstate Protection. The red line representing policy in force growth shows a continued positive trend that's being driven by all 3 underwriting brands. Policies in force grew by 840,000 or 2.5% from year-end 2013. The Allstate brand accounted for 78% of policy growth in 2014 compared with 27% in 2013. Average premium increases to reflect increased costs raised the total premium growth rate above unit growth.

Exhibit to the right of this chart highlights the Property-Liability recorded and underlying combined ratio trends. You can see the consistency in our underlying results for the last 8 quarters as well as the quarterly seasonality we experienced in both the first and fourth quarters each year. You can also see from the red line that while the fourth quarter recorded combined ratio of 90 was the lowest in the year, it was due to the fact that lower catastrophe losses offset an increase in non-catastrophe losses driven by higher auto accident frequency.

Page 7 highlights Allstate brand auto growth and margin trends. Focusing on growth in the chart on the top. Policies increased by 554,000 in 2014, which was 2.9% higher than 2013 driven by continued favorable new business and stable retention trends. Net written premium grew 4.5% in 2014 as average premiums increased to reflect loss cost increases.

Chart on the lower left shows the consistent range of margin performance of Allstate brand auto. Maintaining auto profitability remains a critical priority for us and one of which we have established a long history of success through pricing discipline, underwriting and claims management.

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The underlying combined ratio was 94.2 in 2014, 0.2 point better than 2013. While the annual result was within our expected range of performance, we did experience a spike in the underlying combined ratio in the fourth quarter as you can see in the details on the right.

Annualized average premium per policy, shown by the blue line, continued to increase over the prior year in the quarter. However, average underlying losses and expenses per policy, shown by the red line, increased 4% in the fourth quarter compared with the fourth quarter of 2013. This increase was the result of higher levels of accident frequency experienced in the first 2 months of the quarter, which was driven by a combination of increased economic activity and non-catastrophe weather.

Table below the graph shows the dollar margin per policy on this business by quarter to show the impact of seasonality. The blue boxes show the auto margin for the fourth quarter for the last 5 years. You can see that the $16 for 2014 is below 2012 and '13 but is in line with 2010 and '11. There's obviously a story for every statistic underneath these numbers, but this does show how seasonality can impact the results.

In addition to adjusting prices for the frequency increases, we also closely watch severity levels. On a paid basis, bodily injury severity in the fourth quarter of 2014 was 6% higher than the prior year quarter. We did not experience a similar increase in our estimates of ultimate incurred severity for BI, but as always, we'll continue to monitor these trends and adjust pricing to hit our return targets.

Moving on to Page 8. Allstate brand homeowners increased by 29,000 policies from the prior year quarter. Homeowner policy growth continues to be geographically focused in markets with adequate pricing and acceptable catastrophe exposure. Both increased new business sales and higher customer retention led to the growth.

The chart on the bottom left shows the continued strength of homeowner profitability. We earned $1.1 billion in homeowner underwriting income in 2014 despite paying $1.4 billion in catastrophe losses. Combined ratio of 82.5 for the full year generated an acceptable long-term return on capital.

Moving to the lower right. Annualized average premium, shown in blue, continued to increase, although the rate of increase was lower than recent history, reflecting improved returns. Average underlying losses and expenses per policy increased 3.3% to the prior year quarter. Frequency performed below prior year in 2014, and the 7.7% increase we expect -- we experienced in paid severity in the year was due in part to a shift in the distribution of types of claims. As the economy has improved, we received fewer theft claims, which tend to be less costly than the other homeowner perils we cover. Like auto, homeowner rate increases now are mostly intended to keep pace with trends and maintain margins.

Page 9 provides an overview of growth and profit trends for Esurance and provides more detail behind Tom's opening comments. Starting on the left-hand side of the slide, Esurance's rate of policy and total net written premium growth continues to slow due to ongoing pricing and underwriting actions underway to ensure long-term profitable growth as well as the increasing size of the business. Total Esurance premiums grew by 15.5% in 2014, and policies in force grew 12.6% compared with 2013. Spending on expansion initiatives contributed approximately 2.7 points to the Esurance expense ratio in 2014, masking a 1 point improvement in the underlying loss ratio from year-end 2013.

Page 10 provides an overview of growth and profit for Encompass. Encompass policy in force growth, illustrated by the red line in the chart on the left, continues to slow, reflecting actions taken to ensure acceptable long-term returns. Average premium increases driven by profit improvement actions helped to increase premium as shown by the blue line. As you can see on the right, Encompass' fourth quarter 2014 recorded combined ratio of 93.1 improved sequentially from the previous 2 quarters as homeowner results benefited from less severe weather patterns. Comparison to the prior year quarter was impacted by favorable loss development recorded in the fourth quarter of 2013. Encompass' trailing 12 months recorded combined ratio deteriorated to prior year, primarily driven by catastrophes, non-catastrophe-related weather and lower prior year reserve re-estimates. The underlying combined ratio of 93.7 remained flat to prior year.

And with that, I'll turn it over to Steve to cover Allstate Financial investments and capital management.

Steven E. Shebik

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CFO & Executive VP

Thanks, Pat. Turning to Slide 11. As we discussed last quarter, our strategy is for Allstate Financial to become more integrated with the Allstate brand's customer value proposition. Expanding Allstate customer relationships to Allstate Financial's products and services will further our agents' positioning as trusted advisers. Allstate Financial results for the quarter and full year are highlighted on the top of this slide.

Premiums and contract charges declined by 8.3% in 2014 due to the sale of Lincoln Benefit Life. Excluding 2013 LBL results, Allstate Financial grew premiums and contract charges by 2.8% over the prior year. Operating costs declined by 17.5% or $99 million for the full year 2014, the result of actions to improve strategic focus and modernize the operating model. Operating income for the year was $607 million, 31.7% higher than 2013 when excluding the impact of the LBL disposition, due primarily to strong limited partnership income, lower expenses and profitable growth at Allstate Benefits.

The chart on the bottom of this page shows the change in reserves and contractholder funds from year-end 2007 to year-end 2014. As you can see, Allstate Financial's product liabilities have been reduced by over 50% since 2007 due to actions taken to reduce exposure to spread-based annuity products along with the sale of Lincoln Benefit Life. Select estimated historical results for Lincoln Benefit Life are provided on our investor supplement to provide you with further context.

Shifting to investments on Slide 12. Our total portfolio return on the top was 1.1% for the fourth quarter, bringing total return for the full year 2014 to 5.8%. You can see that the valuation impact varies from quarter to quarter, primarily with changes in interest rates, while the income yield has been relatively constant.

The lower half of the slide provides the investment income and yield for the Property-Liability in Allstate Financial portfolios. The Property-Liability interest-bearing yield in the lower-left graph reflects the impact of duration shortening in 2012 and 2013 and ongoing investment in the current low-interest-rate environment. The interest-bearing portfolios yield is close to current market yields and will respond more quickly to changes in interest rates as a result of this shorter maturity profile.

Moving to the Allstate Financial portfolio in the lower right. The interest-bearing portfolio yield is higher and is more stable than the Property-Liability segment due to its longer duration and because portfolio cash flows had been used largely to fund reductions in our annuity obligations.

In addition, total investment income reflects the impact of the LBL disposition in the second quarter of 2014 and the previously mentioned reduction in annuities. Both the Property-Liability and Allstate Financial portfolio total yields illustrate the variability in income that may result from limited partnership and other equity investments. As we've discussed in prior quarters, we expect these investments to increase returns in both portfolios, but results may vary from period to period.

Slide 13 provides an overview of our capital position and shareholder returns as of year-end 2014. We continue to be in a strong capital position, a reflection of excellent earnings and a proactive approach to managing our balance sheet. Book value per common share reached $48.24, increasing 6.5% since year-end 2013. Operating income return on equity was 12.6% for the year, reflecting the impact of lower operating income and a higher equity base.

Cash return to shareholders is shown in the upper-right graph. Shareholders received cash returns of $368 million in the fourth quarter as we repurchased 251 million of common shares to the settlement of our second accelerated share repurchase program in open market purchases and paid $117 million in common stock dividends. Total common shareholder cash returns for the year were $2.78 billion and included quarterly dividends to $750 million accelerated share repurchase programs and open market share repurchases. As of December 31, 2014, $336 million remained under the company's $2.5 billion share repurchase program authorized last February. We expect to finish this program in the first quarter of this year.

Yesterday, the board continued its practice of returning excess capital to shareholders by increasing the dividend and approving a new share repurchase program. The common dividend was raised 7% to $0.30 per common share for the first quarter of 2015. In addition, a $3 billion share repurchase program was

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approved for execution through July 2016. With $3.4 billion of invested assets at the holding company and a debt-to-capital ratio below 19%, we have the financial capacity both to grow our businesses and execute these programs.

Now let's open up the call for your questions.

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Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Josh Stirling from Bernstein.

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

So Tom, I wanted to ask a question, if I may, about Esurance and Encompass and thinking about margins for the overall company, driving some higher margins into these 2 smaller segments would seem to be some of your biggest levers for improving the combined -- overall combined ratios. And I'm wondering if you can sort of walk us through a bit more detail what your targets are for these businesses, some of the things you're doing to drive margins and if there's any specific challenges that we should understand because big picture, it feels like these are things that ought to offer you higher margins than you're able to deliver. Today, you've got a mass affluent business at Encompass, and obviously, Esurance has got attractive direct economics. But I'd really love to hear you walk through how you compare and contrast the long-term margin potential of both of these businesses and kind of what you're doing in both of them to get us there.

Thomas J. Wilson
Chairman & CEO

All right. Well, thank you, Josh. It's a good question. I'll provide some overview, and then I'll ask Kathy to talk a little bit about Encompass and Don to talk a little about Esurance. First, you're absolutely correct that those 2 businesses -- obviously, the math shows you that they don't generate the same amount of underwriting income as we get from the Allstate brand, and that is one of the reasons why we slowed the growth, is we want to diversify our profit sources amongst those. That said, we have different opportunities in the 2 areas, and we're investing differently in each of those. So -- but let me first talk about -- the Allstate brand is also a growth opportunity, as you can see from this quarter's results, and we can get back into that later if other people have questions. But I don't want people to feel like that's -- you saw we're adding agencies. The growth is picking up across product lines, so that's a good growth vehicle for us as well. The combination of all 3 of those brands gives us really a way to compete aggressively with people on a whole variety of fronts. And so managing those as a portfolio is important both from a go-to-market standpoint, a strategic standpoint and obviously, a financial standpoint. As it relates to Encompass, it is focused on the mass affluent. We need to raise returns in both of the auto and property businesses. The property business actually has a decent combined ratio relative to 100, but it doesn't have a good enough combined ratio relative to the returns we think it needs to have given the long-term volatility in that business. It bumps around a little more in terms of its profitability than you would see in the Allstate brand because it is geographically concentrated east of the Mississippi rather than across the country, so -- which sometimes confuses people as to why its results are down. But it had, obviously, high catastrophe losses this year, and they need to price for that. And Kathy can talk about specifically what they're doing to improve profitability. And as you would expect, a by state and by line kind of issue for us because we run this -- we try to manage this business as we do our other businesses at a local level. The Esurance story is slightly different. That is a good growth opportunity. We believe we can continue to pick up share in that business, and we're willing to invest profitability from around the company to do that. So if you look at our advertising expense, it's relatively high compared to competitors in the direct space. So you might see people spending about 10% in the direct space towards premiums on a sustainable basis. We're in the high teens, high end, so we're okay investing that additional money to drive growth as long as we believe that the returns on a long-term basis are attractive because then it's just a math problem in terms of how the accountants count up the profitability. We look at the cash returns on everything we do. So we think the returns -- we know the returns are above our cost of capital, but we think they can be better, particularly when we compare them to what we're doing by state in the Allstate brand. So Don and the Esurance team are working to both improve that underlying loss ratio and then manage the growth, but the combination of those 2 has brought its growth down, and we're starting to see the benefits to loss

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ratio, so -- but Don can give you some specifics. Kathy, why don't we start with Encompass? And then let's go to Esurance.

Katherine A. Mabe
Executive Vice President of Brand Distribution

Okay. Thanks, Josh, for the question. In terms of Encompass, our goal this year is to return Encompass to a true underwriting profit, so we took a number of actions. We're always concerned about elasticity in this channel as we put rate and underwriting actions in. If you look at retention for both auto and home, it looks like we could have taken even stronger action, and we're prepared to do that in 2015 because our retention held as we put rate into auto and somewhat into home. The actions that we are taking are geared toward specific states that really have out-of-balance profitability challenges, and we have 5 key states that really need strong underwriting and pricing action, and that's already well underway. In addition, we're trying to reposition distribution to get to more profitable growth opportunities for Encompass. So those actions are also going on simultaneously. I think the biggest opportunity for us is to continue to have strong discipline on the underwriting side, particularly in those problem states. And so if -- I don't want to take too much time to go into detail, but it's a multiple grouping of levers that we're trying to pull simultaneously to improve the profit for Encompass. I think, also, it's safe to say that if you look at the amount of rate that we put into Encompass for the year, in auto, we took about 6.6%, and I think there's opportunity to take even more in 2015 because our retention was actually up 1 point in auto.

Thomas J. Wilson
Chairman & CEO

Don?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Josh, let me see if I can just add a little bit of color to what Tom talked about as it relates to Esurance targets. First, we've been consistent since we put the companies together, that our goal was to run the business in a way that it's economic over the lifetime of the policies that we're writing. And the good news is it's nearly twice as large as it was when we bought it. The bad news is, as a result, it had nearly twice the impact on the overall results, and so it's more noticeable. I would break the combined ratio into 2 pieces when you think about where we're headed with them, the loss ratio and then kind of expenses. The loss ratio showed a point or so improvement this year. That's good. We took a fair amount of rate. We took some underwriting actions because the loss ratio was too high last year. We're seeing it earn into the book. There's more to come. 76.6 is not good enough. We still have more work to do to get that number down. I'd like to think, over time, we'll get another point or 2 out of that. But the loss ratio is still a bit higher than it needs to be. On the expense side, it's a little bit of a different issue. We're trying to balance how much advertising we spend money on so that we can generate what ends up being economically viable long-term growth. And so it's a seasonal advertising spend. It's a bit of a seasonal business. We have quarters like the first quarter of last year where we spent an awful lot due to the Super Bowl and the launching of the campaign. But when you look throughout the year, Tom's right. 17.4 points is high, but it's still resulting in an economic lifetime return for the business. The other piece I wouldn't ignore because it's a big number is that there's a lot of expansion taking place. So Esurance is in far more states. It's got far more product with the bundled homeowners and motorcycles and renters policies, and that is taking its toll on the expenses as well to the tune of about 2.7 points this year. So when you put it together, I think there's some room for improvement that I -- let me say it more affirmatively. There's some expectation for improvement in the loss ratio. But on the advertising and the growth expenses, it's a balancing act, and what we don't want to do is choke the growth on the business just to satisfy a GAAP ratio. But we're conscious that it's impacting the company as Esurance continues to grow, so we just have to balance it. The bottom line is we're continuing to run the business on an economically correct basis.

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

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That's really comprehensive. Just a -- sort of a short longer-term question. Tom, you mentioned big investments, 1 of your 5 priorities to modernize the operating model. I'm wondering if there's anything in particular that you'd like to talk about that we should be looking for that might drive margins over the next couple of years. Or on the growth side, I think you mentioned Answer Financial, you give it some visibility here, and then, obviously, you've been investing a lot in telematics and wondering if there's anything in particular we ought to be watching for, for you guys to do over the next year.

Thomas J. Wilson
Chairman & CEO

Josh, I think you should assume we will always invest in those things that are long term. We have both the earning power and the capital to invest in things like telematics to try to figure out how to grow in the aggregated channel, what we call, Integrated Digital Enterprise, which is about redoing our system with digitization and sort of straight-through processing. Not such though that those get -- we assume we have to cover that for our shareholders -- cover that with our shareholders, still deliver the profitability and invest for the future, but we don't really have projections as to what that will do for either top line or the bottom line in the short term. But know that we continue to invest for the long term because we recognize that if we don't do something today, we might me unhappy 3 or 4 years from now.

Operator

Our next question comes from the line of Michael Nannizzi from Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I was wondering if you could drill down a little bit further into the auto loss ratio in the fourth quarter. You talked about, Pat -- I think, Pat, you mentioned severe weather, non-cat weather and frequency. Can we get a little bit more idea of how much of each of those contributed and what exactly was the frequency driver on the -- or the driver on the frequency side?

Thomas J. Wilson
Chairman & CEO

Mike, thank you for the question. Matt has been waiting anxiously for your question because he spent untold number of hours over the last, really, 3 months since we saw a tick-up in October. So we were on this early, and he can give you all the specifics.

Matthew E. Winter
President and President of Allstate Insurance Company

Thanks, Mike. Otherwise, I would feel like I had studied for the wrong question on a test. So let me give you some background. And first of all, both Tom and Pat touched on it in their opening remarks. First, at a high-level look at the seasonality that we always see with a combined ratio in the fourth quarter and when you look at Page 7 of the presentation, you'll see a fairly consistent spike in the fourth quarter. You see it clearly in 2010 and 2011. Recall that 2012 fourth quarter was Sandy, so some of the trends that normally appear were masked that quarter in cat. So there is some seasonality in the fourth quarter in the combined ratio. That's one. Second, as I believe Pat mentioned and I believe it was also highlighted in the release, when we talk about the uptick in frequency in the fourth quarter, we noted that there was an uptick in 2 out of the 3 months. It was an uptick in October and November that seemed to moderate, and we had the December that was more in line with prior trends. So we had a 2- out of 3-month tick-up. Third point is what's driving it and what's not driving it. Let me start with what's not driving it. Number one, we saw nothing to indicate that it's a quality-of-business issue or that it's being driven by growth, which is a natural question that you would have since I hope some time during the call we talk about the growth we're achieving in the auto business. And so with all that growth, you question is this somehow related. Well, we looked at new to renewal ratios. We looked at state mix ratio. We looked at rating plan relativities, and we saw nothing in there that would indicate that it was a quality-of-business or growth-related issue. So what is it likely related to? Well, we went back and looked historically over the last 7 to 8 years, and a couple of things emerged. First, 2 factors traditionally drive PD frequency, miles driven and

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precipitation, especially precipitation during peak driving times. Between those 2, miles driven has about roughly 3x the impact of precipitation. Within miles driven, the vast majority is driven by unemployment rate and a much smaller impact actually from gas prices. So I know that people tend to think that it's driven by gas prices, but really, it's driven by economic activity and the improvement in unemployment rates. In fact, 11 of the last 12 years with lower unemployment rates saw higher miles driven, and so we see a very, very close correlation there. On the BI side, it was elevated. Frequency was elevated, but I would remind you that we had abnormally favorable results in the fourth quarter of '13 because there were more low-impact collisions last year due to winter weather. So we had this dynamic last year, PD was up 1.4 and BI frequency was down 1.7. When you look at it over a 2-year basis and you take out some of that noise from prior year, PD and BI are much more consistent. PD is up 1.9 and BI, up 2.2. So we take all of that and we say, "So what do we do with all of that?" Well, what we do is what we do best as a company, which is continue to manage margins effectively using our combination of a centralized system and a decentralized rate management system. So we are taking our local market operating committee work, looking at what's emerging on a state-by-state and geography-by-geography level, and we take rate as needed. I know some of you believe that we've moderated our rate actions. I would just say that we stabilized our rate actions as we've gotten to the point where rates are more appropriate and we are in a better position to take smaller, more stable, more consistent rate as needed to follow trends, and that's exactly what we're doing. We're under no constraints. We can take rate if indicated and if we need to. And we will take rate if we need to and if the trends indicated. But we've been fortunate that we've been able to take moderately consistent rates, which has enabled us, I think, to compete more effectively with our peers. So I think the system is highly efficient at maintaining margins. I think we are reacting quickly. I think we are, I use a phrase, appropriately paranoid. I think we get paid to worry a lot and to focus intensely a lot, but in no way are we panicked or in no way are we concerned that it's a quality issue, and we'll continue to manage it the way we do and have done for many, many years.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I mean, I guess, so the bottom line then is, I mean, from your perspective, it sounds like you understand what happened, and you're taking action to address it. So there's not a third factor of why is this happening and what can we do about it that you're concerned about.

Matthew E. Winter
President and President of Allstate Insurance Company

We're confident that we have analyzed this to death, some might say. We understand the drivers. We understand the dynamics in the marketplace, and we know how to use the levers available to us to react to it to maintain margins.

Thomas J. Wilson
Chairman & CEO

Which is why we committed to 87 to 89 for next year.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

And then just one real quick one on capital. Just looking at $3.4 billion in holdco capital, this year, it's up 20-ish percent from last year, which is up considerably from the year before. Without Lincoln Benefit there and kind of a more streamlined infrastructure, how should we think about what that -- what you want that number to be on a go forward? And also, just trying to reconcile, too, just a bit of a lighter buyback in the fourth quarter. What was the thought process there just given that big capital chunk at the holdco?

Thomas J. Wilson
Chairman & CEO

Yes. Mike, let me give you a -- start with the second one first, and then Steve can give you some specifics on ASRs and the impacts. So first, as it relates to the share buyback, the $2.5 billion that we're -- we'll be competing this first quarter, you'll remember when we set that out, there was $2.5 billion over 18 months,

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and we'll clearly be done with it a lot sooner than that. So we've been buying shares back aggressively and ahead of schedule because we have the capital both in the company and at the holding company level. Steve can talk about the impact. I know you had a question on the fourth quarter rate, so he can help you sort through that piece. And as it relates to holding company cap, we think about capital for the whole company, and we try to have -- to the extent the capital and the cash is at the holding company, we have more flexibility with that. So we have a process of having -- moving it up as often and frequently as we can. If it needs to go down to a subsidiary, like it has in the past, then we do that. If the subsidiaries are appropriately capitalized, then we like to keep somewhere around $1 billion up there, which covers a year's worth of dividends and interest payments so that if anything were to happen in the subsidiaries. But we could obviously, given our debt capacity, run much lower than that, and so if we had a use for that capital, one way or the other, we could run with very little cash at the holding company. You want to talk about...

Steven E. Shebik
CFO & Executive VP

Yes. So we execute our share buybacks a number of ways, one, open market purchases obviously. A second that we've used the last couple of years are accelerated share repurchase programs, and when you see the bumps between quarters, it's generally because of the accelerated share repurchase buybacks. Those are front-end loaded essentially. So the particular one in the last half of the year, we entered into, after our second quarter earnings, $750 million program, provided 4.5 months of buyback for the investment bank that executed that for us. So over that period of time, in the third quarter, you saw roughly $1 billion of buybacks. In the fourth quarter, you saw $250 million. And that's because we gave the $750 million to the investment bank back at the beginning of the program. They bought back. They effectively gave us a significant portion of the stock they will buy back under that program over the next 4.5 months. We recorded that in the third quarter. And in the fourth quarter, we just have a settle up, which happened in mid-December, which is about $100 million -- a little bit about $100 million and 1.6 million shares, something like that. That's why you saw such a low number in the fourth quarter. Same phenomenon happened in the earlier in the year, if you remember, in the first quarter to second quarter.

Thomas J. Wilson
Chairman & CEO

Mike, let me maybe provide some economic perspective. Why would you use an accelerated share repurchase, right? So what happens is Steve writes a check to the investment bank. They give us a whole bunch of shares. Those go off of the share count, which, obviously, has an impact on your recorded shares, which helps with operating earnings per share. But that's not why we do it. We do it because it's economic. We don't do anything for bookkeeping around here. We -- other than keep the books well, as opposed to -- they're looking at me like he's about to shoot me. But we do it because we essentially sell off the volatility. By entering into an ASR, we can sell off of the volatility, and we end up with a lower net economic cost of purchasing the shares.

Operator

Our next question comes from the line of Vinay Misquith from Evercore.

Vinay Gerard Misquith
Evercore ISI, Research Division

So the first thing is, Matt, I think you studied for the correct test. So the question is on the frequency on the personal auto, curious as to whether you think this is an industry issue or something that just Allstate is seeing. And as a follow-up to that, how much of rate do you think you need to take to offset this higher frequency?

Matthew E. Winter
President and President of Allstate Insurance Company

Thanks, Vinay. First of all, it's really impossible to compare Allstate's results to competitor results. There's different books, different geographic locations, different starting points in history. And remember, a lot

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of what we're talking about is versus the prior year, so we all started in different places. So I can't talk about what other competitors might be experiencing and might not be and by what measures they are. I can say that precipitation and unemployment rates are not Allstate peculiar issues. They're environmental issues. So they may impact competitors differently based upon our geographic footprint, based upon where the precipitation occurred and based upon the books of business. But they're not going to be related specifically to the company. They're related to the general environment. So I would expect that we would see some indications and we have. I think most people have been attributing it to gas prices, to the miles driven, which I think is, as I said earlier, just a moderately important piece of this, while I think the unemployment rate is more significant. On the rate question, we'll take as much rate as we need to maintain margins as is indicated in each geography as appropriate. I don't tell you in advance because I don't know what will emerge. But you look at our history, you look at our quarterly history over the last many, many years, and we'll take rate as needed, and we maintain margins. We're quick to react. We're fortunate in that our structure allows us to take rate quickly, and it earns in quickly. And as a result, we don't have long-term dislocations between indications and reactions.

Thomas J. Wilson
Chairman & CEO

Vinay, this is Tom. To long-term trends, I'd point out what Matt -- and reiterate what Matt just said. If you look at our long-term profitability in auto insurance versus the industry, we're obviously in the upper quartile of that. There's about 3 companies that consistently make money. If you look at the homeowners business, the same thing is true, it's a different group of companies, and we were not in that category 10 years ago. We are in that category now with about 3 companies that make most of the money. And then if you look at fast-track results, which is an industry thing, over a long period of time, we show improvements versus the industry, so that supports that number. And if you look at pricing versus our competitors, Matt is exactly right. Our numbers always look like low single digits in total, obviously, bounces around a lot by state. Matt's had to take a lot of rate in. Your question really, if you ask Matt about Michigan, he'll give you a different answer than if you ask him about Wisconsin. The -- so -- but ours tend to be frequent and small. Some of our other competitors, particularly in the auto space, bump around a little more than we do.

Vinay Gerard Misquith
Evercore ISI, Research Division

Sure, that’s helpful. The second question is -- I was wondering if you could comment on Google's proposed entry into selling insurance online. Would Allstate be willing to join that marketplace?

Thomas J. Wilson
Chairman & CEO

Vinay, I would say we're in that marketplace with the largest aggregator that there is today. So Answer Financial is the largest, at least, as far as we know. It's not really industry specific on that upper-right quadrant. It's not like there's a specific industry study on that. But Answer Financial does over $0.5 billion in premium for other companies. A lot of it is done online through the web or through the call centers. So it is -- it serves that self-serve aggregator customer, which would be the people purportedly that Google would be attempting to -- they've been talking about doing that for some time. We're in the marketplace. It's not as big a market as you would see in the U.K. and other places for a whole bunch of dynamics, which is a longer conversation. But I would say we're there and active.

Operator

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

Jay H. Gelb
Barclays PLC, Research Division

For the Allstate brand, we've seen favorable acceleration of policy in force growth every quarter for the past several, so I just wanted to confirm whether that trend will continue.

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Thomas J. Wilson
Chairman & CEO

Let me have Matt deal with that because he's very happy that you asked the question and very happy with himself as am I.

Matthew E. Winter
President and President of Allstate Insurance Company

Yes. So thank you for noticing. Look, it's widespread and it's -- so we had -- we have 44 states that are growing year-over-year in IF growth and standard auto. And what's interesting about it to us is it's driven almost equally now by new business and retention trends, so it's about 50-50. As you noted, it's our sixth consecutive quarter of year-over-year growth, and it's actually our 7th consecutive quarter-over-quarter increase. So the trend line and the momentum is building. I obviously can't tell you exactly how long that will continue. That will depend upon a wide variety of factors. I can tell you that the momentum engine is building. We are -- we added a great number of agencies. And despite the fact that we have probably 30% fewer agencies than we did 4 or 5 years ago, we're at historical high levels of new business production. That's because their productivity is at an all-time high. Quote volumes are at an all-time high, and close rates are dramatically better than they were. So we see that momentum continuing to build as we have points of presence continuing to build, and we have an aggressive growth and recruiting plan, aggressive plans to add additional license sales professionals. And we believe that the combination of that existing growth momentum with all the work we have underway, with trusted advisor, with deepening the relationships, with bringing in the other -- the remainder of the product sets, with bringing in life and retirement products, consumer household products and truly managing all the risks for our customers and their households, we believe that all of those factors will act synergistically to perpetuate that growth trend line. So we're -- I'm bullishly optimistic on it, but I cannot give you a time frame for how long it will continue at that quarter-over-quarter increase.

Thomas J. Wilson
Chairman & CEO

Jay, I would also encourage everybody to think about growth on a broad basis. So we tend to get into conversations about growth in auto because, obviously, it's our biggest line of business, and the public comparisons are easiest to make between us and other people because that's there. But if you look at -- Matt, is -- the work that's in auto, it's obviously, great. So we're growing, as Matt said, in a whole bunch of states. Homeowners business is also growing as well, and I think in 27 states, Matt, you're up in like 6 of the top 11 or something like that. So he's -- they're -- you're starting to see that grow, too. So as you think about growth, think about it from a customer standpoint, which is selling auto, homeowners, other property lines, which were up 2.1% last year. So this is about building the relationship which also leads to sustainability.

Jay H. Gelb
Barclays PLC, Research Division

Matt, on the frequency issue, you said that the frequency recovered in December. Was that also the case in January?

Thomas J. Wilson
Chairman & CEO

We just closed the month end. Let's just say that, obviously, we were looking at it on the first...

Matthew E. Winter
President and President of Allstate Insurance Company

An hourly basis.

Thomas J. Wilson
Chairman & CEO

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We get claim counts daily, so let's just say we looked at it. We don't give out results, but it didn't -- we did know what the numbers were before we committed to 87-89.

Steven E. Shebik
CFO & Executive VP

Let you know in May.

Jay H. Gelb
Barclays PLC, Research Division

Okay, so it doesn't seem -- I mean, it seems like it was more of a 2-month split in 4Q rather than an ongoing basis.

Thomas J. Wilson
Chairman & CEO

I think I would focus on the point Matt made, which is think of the system. We have a system of adapting, adjusting. It's local. It's centralized. And whatever happens, whether it's frequency, severity, mix of business, we're about doing a good job for our customers and making sure our shareholders are well compensated for that.

Jay H. Gelb
Barclays PLC, Research Division

That makes sense. And the last one is on the capital management plan. So over the past 2 years, it looks like the share count has been reduced as a result of buybacks by 6% to 7%. It seems like that might even accelerate in 2015. I'm just trying to get a sense of if you think about reducing the share count as a capital management goal consistent with the dollar amount of capital returned.

Thomas J. Wilson
Chairman & CEO

No, we look at it on a dollar basis.

Operator

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

Sarah Elizabeth DeWitt
JP Morgan Chase & Co, Research Division

Could you talk about your appetite to do a significant reinsurance deal on the homeowners business? And would you consider reinsuring a significant portion of the business or maybe even the whole thing given that reinsurance market conditions are increasingly favorable? And if so, do you think you can find a counterparty for that?

Thomas J. Wilson
Chairman & CEO

It's a good question. As you know, the -- we have number of sources of capital, our own money, which we get from shareholders. We have capital we can get from reinsurers and increasingly a developing alternative source of capital called cat bonds or sidecars or a variety of other things. And that market is growing quite rapidly. There are a number of people who want to get into that market because the returns are uncorrelated with overall market returns. And so we see that growing. That capital has been coming in at a lower cost of capital than provided to us by external sources. So we've been actively using that. Steve, you did a -- what was the size of the cat bond this year?

Steven E. Shebik
CFO & Executive VP

2014 was just under $1 billion in total.

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Thomas J. Wilson
Chairman & CEO

So we did a cat bond this year because we thought it was cheaper than traditional reinsurance. We have looked at replacing some of our own capital with third-party capital. We look at that all the time. It just -- it's whether you use preferred stock or common stock or third-party alternative capital. We have a number of requirements that we have on that, which have not yet been resolved in terms of how to do it. But I can tell you that we continue to look at it quite aggressively. Those requirements are -- we need some stability in our pricing on behalf of our customers. We don't want to be out in the market every year trying to find $2 billion, $3 billion, $4 billion worth of capital and what are we going to charge our customers for it and have to run that through prices. Secondly, it has to meet our economic standards that it's a good trade for us. And then thirdly, there's a whole bunch of, what I would just say, legal accounting hurdles one has to get through so that it's displayed in the reported financials the way the economics are set up. Sometimes things show up as derivatives and stuff like that, and it just makes everybody's life more confusing because the financial structure doesn't show you the economics of that, which we got. So we're hard at work at it. I don't -- I think this is one of those things that develops over time. I think it is -- there's optionality in terms of our ability to further improve our return on capital, and -- but the -- I think the biggest driver will be if we can take some volatility out of the P&L, that should reduce our cost of capital. So if you look at the cost of capital for the auto insurance business, it would be lower than the cost of capital for the homeowners business. To extent Steve can find a way to access alternative capital, reduce volatility, maybe even reduce some of the capital we have in the business, that should not only free up capital, Sarah. It should also improve our PE. So we're hard at work on it. I don't think you expect to see anything in the short term because it is a complicated problem. But if there's -- we are spending a lot of time on it.

Sarah Elizabeth DeWitt
JP Morgan Chase & Co, Research Division

And if you could find the capital, how much of the homeowners business would you want to reinsure versus retain?

Thomas J. Wilson
Chairman & CEO

All depends on the price.

Operator

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

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Pension, $700 million swing on penalty to AOCI, so book value didn't grow. Maybe you could walk through -- I assume it's interest rates that drove that addition. And what -- did you use a year-end sort of interest rate compass? Or were you able to take advantage of the increased knowledge of yields coming down higher in 2015? I guess the question is do we look at another hit like this coming next year if rates stay where they are.

Steven E. Shebik
CFO & Executive VP

So I'll keep -- this is Steve. I'll keep this simple for you. The -- at the end of the year, we mark our pension liabilities to the current interest rate discount -- what we call the discount rate liabilities at 12/31. So the discount rate this year-end 12/31/2014 was almost the same as it was 2 years ago. So what happened is we got a benefit in 2013, and we gave it back at the end of 2014. Secondly, we alone with every other public company, I believe, are adopting new mortality assumptions that the Society of Actuaries issued in October. So that, for financial reporting purposes, increased our liability also. You will -- we will -- we have not and we will not put that in their actual employee calculations until the IRS adopts

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that same program probably in a couple of years. Those are the 2 principal changes you saw. The Society of Actuaries change -- I don't remember when was it was last changed, the mortality assumptions, but it was well more than a decade ago.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

6% or 7%. Yes, it's a decade ago.

Steven E. Shebik
CFO & Executive VP

More than a decade ago. So that happens every decade or so. The discount rate changes every year. So if rates go down at the end of next year, you'll have another increase. If rates go up, you'll get a benefit like we did in 2013.

Thomas J. Wilson
Chairman & CEO

Bob, if you'll remember...

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

And -- go ahead, I'm sorry.

Thomas J. Wilson
Chairman & CEO

You remember last year, we changed our pension benefits and put them all, everybody into the same plan, which had a substantial benefit to the balance sheet and ongoing operating.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Any implications to funding for 2015 cash flow?

Steven E. Shebik
CFO & Executive VP

Nothing other than normal funding considerations we would consider the normal cost of the plan. And over time with this mortality assumption change, we'll probably have to fund more in the plan potentially given the investment returns we get in the assets.

Thomas J. Wilson
Chairman & CEO

So let me close with 4 thoughts: So our strategy focusing on the unique value propositions is working. The Allstate Agency business has excellent prospects for profitable growth. Our business model being in all 4 segments is working as is the ability to have a broad product portfolio. We're seeing some of our competitors take similar -- try to do what we have built. Secondly, we are delivering sustainable growth and profitability. That's our operating expertise. The process is our culture of adapting. Third, we give outstanding cash returns to shareholders. And lastly, we are financially in an extremely strong position, which gives us the resources. We obviously have the will and the ability to continue to compete effectively. So thank you much. I will 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.

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