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Allstate Insurance Group
Combined Management Discussion and Analysis
For the Year Ended December 31, 2003

Allstate Insurance Company ("AIC") is an Illinois domiciled insurer licensed to write property and casualty business in 49 states, the District of Columbia, and Puerto Rico and offers a broad range of personal and commercial insurance products including reinsurance. The Allstate Corporation ("ALCORP"), a Delaware Corporation, owns all of AIC's outstanding 42,000 shares of common stock. AIC's affiliated property and casualty insurers included in its combined statement are: Allstate Indemnity Company, Allstate Texas Lloyd's, Deerbrook Insurance Company, Allstate Property and Casualty Insurance Company, Allstate County Mutual Insurance Company, Allstate Floridian Insurance Company ("Floridian"), Allstate Floridian Indemnity Company ("Floridian Indemnity"), Allstate New Jersey Insurance Company ("ANJ"), Encompass Insurance Company of New Jersey ("ENJ"), Allstate Fire and Casualty Insurance Company, Northbrook Indemnity Company, Allstate North American Insurance Company, Encompass Insurance Company and Encompass Indemnity Company. In accordance with NAIC guidelines, insurers that are part of a consolidated group of insurers and utilize 100% intercompany reinsurance agreements to effectively form a pool of business are permitted to prepare a combined Management Discussion and Analysis ("MD&A"). As AIC assumes all of the underwriting results, via 100% intercompany reinsurance agreements, from Allstate Indemnity Company, Allstate Texas Lloyd's, Deerbrook Insurance Company, Allstate County Mutual Insurance Company, Allstate Property and Casualty Insurance Company, Allstate Fire and Casualty Insurance Company, Northbrook Indemnity Company, Allstate North American Insurance Company, Encompass Indemnity and Encompass Insurance Company collectively referred to as Allstate; the combined results of the aforementioned companies have been analyzed in this MD&A. A separate MD&A will be filed for Floridian, Floridian Indemnity, ENJ and ANJ which do not participate in a 100% intercompany reinsurance agreement, therefore, the results of their operations are not included in the results and analysis provided here.

In addition to its affiliated property casualty insurers, Allstate has several unconsolidated subsidiaries, known as the Allstate Financial brand, the largest of which is the Allstate Life Insurance Company ("Allstate Life"). Allstate Life and its subsidiaries market a broad line of life insurance and investment products. Separate MD&A's will be filed for Allstate Life and certain of its subsidiaries.

INTRODUCTION

This discussion and analysis focuses on the operations of Allstate Insurance Group for the year ending December 31, 2003.

The Company's Property-Liability operations consist of two business segments: Allstate Protection and Discontinued Lines and Coverages. Allstate Protection is comprised of two lines of business, the Allstate brand and Ivantage, and is principally engaged in the sale of personal property and casualty insurance, primarily private passenger auto and homeowners insurance, to individuals in the United States and Canada. Discontinued Lines and Coverages include results from insurance coverage that we no longer write and results for certain commercial and other businesses in run-off. These groupings are consistent with the grouping of financial information that management uses to evaluate performance and to determine the allocation of resources.

ALLSTATE PROTECTION SEGMENT

Our goal for the Allstate Protection segment is to grow profitably and improve and sustain the profitability of our auto and homeowners insurance products. Through the utilization of Strategic Risk Management ("SRM"), a multi-phase strategy that integrates tier-based pricing, underwriting and marketing decisions, we seek to attract and retain high lifetime value customers who will potentially provide above-average profitability over the course of their relationship with us.

The Ivantage business sells private passenger auto and homeowners insurance to individuals through independent agencies. Ivantage includes standard auto and homeowners products with the Encompass℠ brand name and non-standard auto products with the Deerbrook® brand name. Our strategy for Ivantage focuses on improving profitability for both Encompass and Deerbrook, and growing in select markets, in part by using SRM.

The tier-based pricing and underwriting used in SRM produces a broader range of premiums that is more refined than the range generated by our pre-SRM standard/non-standard model that we used and it is designed to enhance both our competitive position and profit potential for these customers.

Our rating plans for private passenger auto insurance are no longer consistently segregated into standard plans and non-standard plans. In some states, we have implemented SRM and modified our underwriting criteria in a way that allows us to write what may be considered both standard and non-standard business with one rating plan, which may also be considered a standard rating plan designed to accommodate non-standard risks. As the implementation of SRM continues, the distinctions between standard and non-standard may become less important in certain states, depending upon how SRM is implemented. For this reason we are shifting our managerial focus to auto, including standard auto and non-standard auto. Generally, standard auto customers are expected to have lower risks of loss than non-standard auto customers.

For Allstate brand standard auto and homeowners business written under SRM, our results indicate an increase in retention and a shift toward more customers who we consider high lifetime value and who have lower loss ratios. The impact of SRM on our non-standard business has been less pronounced because the impact has been mitigated by the effect of other non-standard business initiatives, and as described above, because the implementation of SRM has meant that in some states we write what may be considered both standard and non-standard business with one rating plan.

Because the implementation of SRM began in 1999 and has applied primarily to new business written since that time, today it accounts for about 35% of total premiums written. This amount will continue to increase since over 75% of new business is written using SRM rating plans.

Another element of our strategy for our homeowners insurance business is to target customers whose risk of loss provides the best opportunity for profitable growth, including managing exposure on policies in areas where the potential loss from catastrophes exceeds acceptable levels. Homeowners product pricing is typically intended to establish returns that we deem acceptable over a long-term period of years. Losses, including losses from catastrophic events and weather-related losses (such as wind, hail, lightning and freeze events not meeting our criteria to be declared a catastrophe), are accrued on an occurrence basis within the policy period. Therefore, in any reporting period, loss experience from catastrophic events and weather-related losses may contribute to negative or positive underwriting performance relative to the expectations we incorporated into the products' pricing. Accordingly, homeowners products are more capital intensive than other personal lines of products.

Allstate Protection's goal is to achieve pricing targets comprising a competitive combined ratio and return on equity. Our primary strategies to achieve this goal include continuing our efforts to seek approval for rate changes for all Allstate Protection products in all jurisdictions where we believe such changes are needed and can be obtained, and to pursue other actions affecting our profitability such as improving our underwriting and claims processes.

DISCONTINUED LINES AND COVERAGES SEGMENT

Discontinued Lines and Coverages includes results from insurance coverage that we no longer write and results for certain commercial and other businesses in run-off. We have assigned management of this segment to a designated group of professionals with expertise in claims handling, policy coverage interpretation and exposure identification. Our exposure to asbestos, environmental and other discontinued lines claims arises in this segment.

FINANCIAL POSITION

Cash and Invested Assets

The investment strategy emphasizes safety of principal and consistency of income within a total return framework. This approach is designed to ensure financial strength and stability for paying claims while maximizing economic value and surplus growth. The method for achieving this goal is based on a strategic asset allocation model, which takes into account the nature of the liabilities and risk tolerance as well as the risk/return parameters of various asset classes. This modeling, along with duration and liquidity considerations, is the guide for our asset allocation. On a tactical basis, decisions are made based on analysis of relative value opportunities across markets. Performance is measured against outside benchmarks as target allocation weights. Reviews of the portfolio are conducted regularly, including a portfolio monitoring process that identifies securities that are impaired on an other than temporary basis. This approach to balancing total return management with income needs and risk tolerances has produced competitive returns over time.

The composition of the investment portfolio at December 31, 2003 is presented in the table below.

(in millions)		2003	Percent to total	
Bonds	$	26,204	70.0	%
Preferred stock		376	1.0	
Common stock		9,323	24.9	
Real Estate		340	1.0	
Mortgage Loans		64	-	
Short-term investments		647	1.8	
Other		471	1.3	
Total	$	37,425	100.0	%

Total investments increased to $37.43 billion at December 31, 2003 from $32.74 billion at December 31, 2002, due to positive cash flows from operations and increased unrealized gains on common stock, partially offset by dividends paid by AIC to The Allstate Corporation. The Company generally holds its bonds to maturity, but has classified all bonds as available for sale to allow maximum flexibility in portfolio management.

Municipal bonds, including tax-exempt and taxable securities, comprise $18.21 billion or 69.5% of the Company's bond portfolio at December 31, 2003. Investment grade municipal bonds represent approximately 94.7% of the total and the remainder are primarily private placement bonds.

Corporate obligations that are publicly issued totaled $2.47 billion at December 31, 2003 compared to $2.13 billion at December 31, 2002. As of December 31, 2003, the bond portfolio contained $564 million of privately placed corporate obligations, compared with $458 million at December 31, 2002. The benefits of privately placed securities when compared to publicly issued securities are generally higher yields, improved cash flow predictability through pro-rata sinking funds on many bonds, and a combination of covenant and call protection features designed to better protect the holder against losses resulting from credit deterioration, reinvestment risk and fluctuations in interest rates. A disadvantage of privately placed securities when compared to public securities is relatively reduced liquidity.

At December 31, 2003 and 2002, $2.87 billion and $2.63 billion, respectively, of the bond portfolio was invested in mortgage-backed securities ("MBS"). In our MBS portfolio, the credit risk associated with MBS is mitigated due to the fact that the portfolio consists primarily of securities that were issued by, or have underlying collateral that is guaranteed by, U.S. government agencies or U.S. government sponsored entities. The MBS portfolio is also subject to interest rate risk since the price volatility and ultimate realized yield are affected by the rate of repayment of the underlying mortgages. We attempt to limit interest rate risk on these securities by investing a portion of the portfolio in securities that provide prepayment protection.

The bond portfolio contained $1.39 billion and $2.60 billion of asset-backed securities ("ABS") at December 31, 2003 and 2002. The ABS portfolio is subject to credit and interest rate risk. Credit risk is mitigated by monitoring the performance of the collateral. Approximately 99.6% of the ABS portfolio is rated investment grade. The ABS portfolio is subject to interest rate risk since the price volatility and ultimate realized yield are affected by the rate of repayment of the underlying assets. Approximately 39.0% of the Company's ABS portfolio is invested in securitized credit card receivables. The remainder of the portfolio is primarily backed by securitized home equity and auto loans.

At December 31, 2003, approximately 94.6% of the Company's consolidated bond portfolio was rated investment grade, which is defined as a security having a rating from The National Association of Insurance Commissioners ("NAIC") of 1 or 2, a Moody's equivalent rating of Aaa, Aa, A or Baa, or a comparable Company internal rating.

Equity Securities Equity securities include common and preferred stocks, and investments in affiliates. The increase is attributable to higher unrealized net capital gains during 2003, new money from operations and an increase in the underlying book value of Allstate Life and Allstate Insurance Company of Canada.

Mortgage Loans Allstate's investment in mortgage loans decreased from $75 million at December 31, 2002 to $64 million at December 31, 2003. The decrease is a result of the Company no longer investing in new loans; however, there are approximately 10 loans of significance remaining in the portfolio.

Short-Term Investments Our short-term investment portfolio was $649 million and $951 million at December 31, 2003 and 2002, respectively. We invest available cash balances primarily in taxable short-term securities having a final maturity date or redemption date of one year or less.

We also participate in securities lending, primarily as an investment yield enhancement, with third parties such as brokerage firms. We obtain collateral in an amount equal to 102% and 105% of the fair value of domestic and foreign securities, respectively, and monitor the market value of the securities loaned on a daily basis with additional collateral obtained as necessary. The cash we receive is subsequently invested and included in short-term and bond investments, and an offsetting liability is recorded in other liabilities. At December 31, 2003, the amount of securities lending collateral reinvested in short-term investments had a carrying value of $298 million. This compares to $638 million at December 31, 2002.

Other Assets

Other invested assets decreased $167 million, or 26.1%, from prior year primarily due to investments paid down or sold. Investment income due and accrued increased $60 million, or 14.4%, primarily due to an increase in subsidiary dividends receivables from Allstate Life Insurance Company. Net deferred tax asset balance decreased $184 million, or 15%, due to the pension liability. Other assets increased $119 million, or 70%, primarily due to aggregate write-ins for other than invested assets. The increase was due to the admission of $68 million in pension intangible assets and the purchase of $50 million in additional Company Owned Life Insurance ("COLI").

Reserves for Losses and Loss Adjustment Expenses

Reserves for losses and loss adjustment expenses increased $671 million, or 5% from $13,323 million in 2002 to $13,994 million in 2003.

Other Liabilities

Taxes, licenses and fees increased $26 million, or 13.8% due to increased state premium taxes resulting from increased written premiums. Current federal income tax payable increased $219 million, or 100%. In 2002, current federal income tax was in a recoverable position. The change in this account was due to the change in underwriting income. Borrowed money increased $262 million, or 100% due to the investment decision to expand the dollar-roll program in 2003. Advance premiums increased $204 million, or 44.5% due to a change in reporting premiums received prior to the policy effective date. The mechanized billing system records a premium receivable and advance premium for the difference between the total policy premium amount and cash payment for premiums received prior to the policy effective date. An adjustment was made as of December 31, 2003 to reduce the gross-up of premium receivable and advance premium. Accounts payable increased $122 million. The balance in accounts payable primarily consisted of CNA salvage and subrogation amounts, accounts payable for the restricted stock plan and other payables.

Capital and Surplus

The following table summarizes Allstate's capital resources at the end of the last two years.

(in millions)	2003	2002
Common capital stock	$ 4	$ 4
Gross paid in and contributed surplus	2,166	2,138
Unassigned funds (surplus)	13,876	11,561
Aggregate write-ins for special surplus funds	57	60
Total surplus as regards policyholders	$ 16,103	$ 13,763

Total surplus as regards policyholders increased $2.34 billion to $16.10 billion in 2003 from $13.76 billion in 2002. Reflected in the change were increases in net income of $1.3 billion and unrealized capital gains of $1.29 billion. During 2003, the Company made contributions of $851 million to its qualified pension plans. The effects of these contributions decreased the minimum pension liability net of tax by $430 million, however, surplus did not increase because the amounts resulted in an increase to prepaid pension assets, which were non-admitted, by the amount of the contributions.

RESULTS OF OPERATIONS

(in millions)	2003	2002
Premiums earned	$ 22,525	$ 21,415
Losses incurred	13,292	13,608
Loss expenses incurred	2,675	2,773
Other underwriting expenses incurred	5,733	5,242
Total underwriting deductions	21,700	21,623
Net underwriting gain or (loss)	825	(208)
Net investment income earned (net of expenses of $1,583 and $1,188)	1,772	1,757
Net realized capital gains or (losses)	272	(454)
Net investment gain or (loss)	2,044	1,303
Total other income	247	259
Net income, after dividends to policyholders but before federal and foreign income taxes	3,116	1,354
Federal and foreign income taxes incurred	389	(76)
Net income	$ 2,727	$ 1,430

The Company experienced an underwriting gain of $825 million during 2003 compared to a loss of $208 million in 2002. The improvement in underwriting income in 2003 was due to increased premiums earned, declines in auto claim frequency (rate of claim occurrence) and favorable prior year reserve reestimates, partially offset by increased catastrophe losses, increased operating costs and expenses and increased current year claim severity (average cost per claim) in Allstate Protection. In discontinued lines and coverages during 2003, the underwriting results included reserve increases for asbestos totaling $513 million. Our annual "ground up" review of reserves for asbestos, environmental, and other discontinued lines exposures resulted in an increase in asbestos reserves totaling $441 million. During the year, asbestos reserves were also increased $34 million due to new information received for two manufacturing insureds in bankruptcy, and by $38 million for an excess insurance policyholder who submitted new and unanticipated claims that were for previously not designated, and therefore unexpected, coverage years. Reserves for uncollectible reinsurance recoverable and bad debts were increased by $26 million. The cost of administering claims settlements totaled $23 million for the year ended December 31, 2003.

In 2002, the underwriting loss was also primarily due to our annual review of reserves for asbestos, environmental and other discontinued lines exposures. Results included an increase in reserves totaling $231 million, including increases for asbestos of $121 million, environmental of $26 million, other discontinued lines of $45 million, and costs of administering claim settlements and miscellaneous run-off exposures of $39 million.

Changes in auto current year claim severity are generally influenced by inflation in the medical and auto repair sectors of the economy. We mitigate these effects through various loss management programs. Injury claims are affected largely by medical cost inflation while physical damage claims are affected largely by auto repair cost inflation and used car prices. Our rate of increase in incurred injury claim severity during 2003 was lower than the relevant medical cost indices, while during 2002 it was higher than the relevant medical cost indices. We believe our claim settlement initiatives, such as improvements to the claim settlement process, medical management programs, the use of special investigative units to detect fraud and handle suspect claims, litigation management and defense strategies, as well as various loss management initiatives underway, contribute positively to the mitigation of injury severity trends. However, auto injury claim severity could offset the success of these programs as was seen in 2002; therefore, we will continue to pursue claim mitigation programs and profitability actions such as rate increases.

For auto physical damage coverages, we monitor our rate of increase in average cost per claim against a weighted average of the Body Work price index and the Used Car price index. In 2003 and 2002, our rate of increase in incurred physical damage current year claim severity was generally higher than the weighted index. We believe that results can be favorably impacted by the application of enhanced claim settlement practices for auto physical damage claims. Accordingly, we continue to pursue various loss management initiatives that we expect to contribute positively to the mitigation of physical damage severity trends. However, during 2003 and 2002 the increase in auto physical damage claim severity more than offset the success of these programs.

Changes in homeowners current year claim severity are generally influenced by inflation in the cost of building materials, the cost of construction and property repair services, the cost of replacing home furnishings and other contents, the types of claims that qualify for coverage, and other economic and environmental factors. In 2003 we experienced a decline in homeowners severity while in 2002 we experienced an increase. Additional losses in 2002 were due to an increase in the volume of mold claims in Texas. We employ various loss management programs to mitigate the effect of these factors; however, homeowners severity may increase, offsetting the success of these programs. We have also taken numerous actions that we expect to contribute to profitable trends in the homeowners loss ratio. For example, we have implemented policy language in Texas and the majority of other states limiting payments for mold claims to $5,000 for specified remediation of mold that results from a covered water loss.

The increase in the expense ratio in 2003 was due to higher agent incentives, marketing expenditures, charitable contributions and employee-related expenses.

Catastrophe Losses

Catastrophe losses are an inherent risk of the property-liability insurance industry that have contributed, and will continue to contribute, to potentially material year-to-year fluctuations in our results of operations and financial position. We define a "catastrophe" as an event that produces pre-tax losses before reinsurance in excess of $1 million and involves multiple first party policyholders, or an event that produces a number of claims in excess of a preset, per-event threshold of average claims in a specific area, occurring within a certain amount of time following the event. Catastrophes are caused by various natural events including earthquakes, wildfires, tornadoes, hailstorms, hurricanes, tropical storms, high winds and winter storms. We are also exposed to human-made catastrophic events, such as certain acts of terrorism or industrial accidents. The nature and level of catastrophes in any period cannot be predicted.

We include catastrophe losses in property-liability claims and claims expense. As a result, catastrophe losses affect both our underwriting results and loss ratios. During 2003, catastrophe losses totaled $1.48 billion, compared to catastrophe losses of $725 million in 2002.

Over time we have limited our aggregate insurance exposure to catastrophe losses in certain regions of the country that are subject to high levels of natural catastrophes. Actions we have taken to limit our exposure include restricting the amount and location of new business; limiting the availability of certain policy coverages; employing policy brokering; and increasing our participation in catastrophe pools. However, the impact of these actions may be mitigated by the effect of state insurance laws and regulations and by the effect of competitive considerations. We have also requested and received rate increases and have expanded the use of hurricane, tropical cyclone and earthquake deductibles in certain regions that are subject to high levels of catastrophes.

We consider the greatest areas of potential catastrophe losses due to hurricanes to be major metropolitan centers near the eastern and gulf coasts of the United States, and the greatest areas of potential catastrophe losses due to earthquakes to be California, areas surrounding the New Madrid fault system in the Midwest and faults in and surrounding Seattle, Washington and Charleston, South Carolina.

Pre-tax net investment income

Pre-tax net investment income increased slightly from $1.76 billion in 2002 to $1.77 billion in 2003. The increase was due to higher portfolio balances resulting from positive cash flows from operations, mostly offset by lower portfolio yields. The average investment yield decreased 50 basis points to 4.71% at December 2003 from 5.21% at December 2002.

After-tax realized capital gains and losses

After-tax realized capital gains and losses were $178 million in 2003 compared to ($295) million in 2002. The following table presents the factors driving the realized capital gains and losses results.

(in millions)	2003	2002
Investment write-downs	$ (57)	$ (68)
Sales	239	(106)
Valuation of derivative instruments	(4)	(121)
Total after-tax realized capital gains and losses	$ 178	$ (295)

The increases in after-tax net realized capital gains and losses was primarily due to a $363 million decrease in common stock trading losses and $181 million decrease in net losses on treasury futures. The 2002 losses from trading stock were due to the effect of a sales program.

CASH FLOW AND LIQUIDITY

The following table summarizes cash flow.

(in millions)	2003	2002
Net cash from operations	$ 3,513	$ 1,831
Net cash from investments	(2,166)	(1,839)
Net cash from financing and miscellaneous sources	(1,581)	62
Net change in cash and short-term investments	$ (234)	$ 54

The Company's operations typically generate substantial positive cash flows from operations as most premiums are received in advance of the time when claim and benefit payments are required. These positive operating cash flows are expected to continue to meet the liquidity requirements of the Company. Higher operating cash flows in 2003 and 2002 were primarily due to increased underwriting income. In 2003, operating cash flows were also impacted by contributions made to our defined benefit pension plans. Cash used in investing activities increased in 2003 and 2002 as higher operating cash flows were invested in the fixed income and equity portfolios. Cash flows are also impacted by dividends paid by AIC to ALCORP. These dividends totaled $1.29 billion and $675 million in 2003 and 2002, respectively.

Dividends

The ability of the Company to pay dividends is dependent on business conditions, income, cash requirements, receipt of dividends and other relevant factors. The payment of shareholder dividends by the Company without the prior approval of the state insurance regulator is limited to formula amounts based on net income and capital and surplus as specified under Illinois insurance law. The maximum amount of dividends the Company can distribute during 2004 without prior approval of the IL DOI is $2.71 billion. Dividends are not cumulative.

In 2003, the Company paid $1.29 billion of dividends, which is below the maximum payment amount that can be distributed without prior approval by the IL DOI.

Financial Ratings and Strength

The following table summarizes the Company's and its major subsidiaries' debt, commercial paper and insurance financial strength ratings from various agencies at December 31, 2003.

	Moody's	Standard & Poor's	A.M. Best
Allstate Insurance Company (financial strength)	Aa2	AA	A+

Our ratings are influenced by many factors including operating and financial performance, asset quality, asset/liability management, overall portfolio mix, the amount of financial leverage (i.e., debt), exposure to risks such as catastrophes, as well as the current level of operating leverage.

The ratio of net premiums written to statutory surplus is a common measure of operating leverage used in the property-casualty insurance industry and serves as an indicator of a company's premium growth capacity. Ratios in excess of 3 to 1 are typically considered outside the usual range by insurance regulators and rating agencies. AIC's premium to surplus ratio was 1.5x on December 31, 2003 compared to 1.7x in the prior year.

RBC

The NAIC has a standard to assess the solvency of insurance companies, which is referred to as risk based capital ("RBC"). The standard is based on a formula for determining each insurer's RBC and a model law specifying regulatory actions if an insurer's RBC falls below specified levels. The formula for calculating RBC takes into account asset and credit risks, but places more emphasis on underwriting factors for reserving and pricing. At December 31, 2003, the RBC for each of our domestic insurance companies was significantly above levels that would require regulatory action.

IRIS Ratios

The NAIC has also developed a set of financial relationships or tests known as the Insurance Regulatory Information System ("IRIS") to assist state regulators in monitoring the financial condition of insurance companies and identifying companies that require special attention or action by insurance regulatory authorities. The NAIC analyzes financial data provided by insurance companies using prescribed ratios, each with defined "usual ranges". Generally, regulators will begin to monitor an insurance company if its ratios fall outside the usual ranges for four or more of the ratios. If an insurance company has insufficient capital, regulators may act to reduce the amount of insurance it can issue. The ratios of our domestic insurance companies are within these ranges.

OTHER ITEMS

The Company participates in various reinsurance mechanisms, including both voluntary and mandatory pools and facilities, and has purchased reinsurance to mitigate long-tail liability lines, including environmental, asbestos and other discontinued lines exposures. The Company retains primary liability as a direct insurer for all risks ceded to reinsurers.