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Allstate Insurance Group
Combined Management Discussion and Analysis
For the Year Ended December 31, 2004

The Allstate Insurance Group ("Allstate" or the "Company") consists of the Allstate Insurance Company ("AIC"), Allstate Indemnity Company ("AI"), Allstate Texas Lloyd's ("ATL"), Deerbrook Insurance Company ("DIC"), Allstate Property and Casualty Insurance Company ("ALPAC"), Allstate County Mutual Insurance Company ("ACM"), Allstate Fire and Casualty Insurance Company ("AFCIC"), Northbrook Indemnity Company ("NIC"), Allstate North American Insurance Company ("ANAIC"), Encompass Insurance Company ("EIC") and Encompass Indemnity Company ("EI"). Insurers that are part of a consolidated group of insurers and utilize 100% intercompany reinsurance agreements 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 AI, ATL, DIC, ALPAC, ACM, AFCIC, NIC, ANAIC, EIC and EI, the combined results of the aforementioned companies have been analyzed in this MD&A.

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.

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. The Allstate Corporation ("ALCORP"), a Delaware Corporation, owns all of AIC's outstanding 42,000 shares of common stock.

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 Encompass. It 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 and achieve profitability that produces attractive returns on our auto and homeowners insurance products. We are seeking, through the utilization of our distribution channels, tiered pricing and consumer marketing, to attract and retain high lifetime value customers who will potentially provide favorable prospects for profitability over the course of their relationship with us. We continue to enhance technology to integrate our distribution channels, improve customer service, facilitate the introduction of new products and services and reduce infrastructure costs related to supporting agencies and handling claims. We have aligned agency and management compensation and the overall strategies of the Allstate brand to best serve our customers by basing certain incentives on Allstate brand profitability and growth and sales of Allstate Financial products. Beginning in 2003, we implemented and maintained a broader marketing approach throughout the U.S. These actions and others are designed to optimize the effectiveness of our distribution and service channels by increasing the productivity of the Allstate brand's exclusive agencies and The Good Hands® Network.

The Encompass brand sells private passenger auto and homeowners insurance to individuals through independent agencies. Encompass brand includes standard auto and homeowners products with the Encompass℠ brand name and non-standard auto products with the Deerbrook® brand name. Our strategy for the Encompass brand focuses on growing profitably, and growing in select markets, in part by using tiered pricing. The integration of Encompass policies onto Allstate systems has resulted in a different counting process for policies in force ("PIF"). As a result, percent changes in PIF and average premium and the renewal ratio are subject to some distortion until the integration has been in place for a full year.

Our sophisticated process for segmenting a market ("tiered pricing"), and underwriting are designed to enhance both our competitive position and profit potential, and produce a broader range of premiums that is more refined than the range generated by the standard/non-standard model. Tiered pricing includes our Strategic Risk Management program which considers, to the extent legally permissible, insurance scoring based on information that is obtained from credit reports as well as a number of other risk evaluation factors. At the same time, we continue to expand the number of tiers with successive rating program releases, resulting in a diminishing capacity to draw meaningful comparisons to historical presentations.

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 tiered pricing 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 tiered-rating plan, which may also be considered a standard rating plan designed to accommodate non-standard risks. As we continue to use tiered pricing and underwriting, the distinctions between standard and non-standard will become less important in certain states. For this reason we are shifting our managerial focus to auto, which is the sum of standard auto and non-standard auto. We also believe it is useful to analyze auto results that aggregate our standard and non-standard business. However, we will continue to provide results for standard and non-standard auto. Generally, standard auto customers are expected to have lower risks of loss than non-standard auto customers.

Substantially all of new and approximately 65% of renewal business written for Allstate brand auto uses tiered pricing. For Allstate brand homeowners, approximately 65% of new and 35% of renewal business written uses tiered pricing. For Allstate brand auto and homeowners business written under tiered pricing, our results indicate an increase in retention and a shift toward more customers who we consider high lifetime value and who generate more favorable loss results.

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. This includes a continual re-evaluation of our countrywide catastrophe risk management strategies for hurricanes and earthquakes. Homeowners product pricing is typically intended to establish returns that we deem acceptable over a long-term period. Losses, including losses from catastrophic events and weather-related losses (such as wind, hail, lightning, freeze and water losses 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 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 based on rate indicators, such as our projected claim frequency and severity experience and expense levels, and to pursue other actions affecting our profitability such as improving our underwriting and claims processes.

DISCONTINUED LINES AND COVERAGES SEGMENT

The Discontinued Lines and Coverages segment 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

Allstate's investment strategy emphasizes safety of principal and consistent income generation, within a total return framework. This approach, which has produced competitive returns over time, is designed to ensure financial strength and stability for paying claims, while maximizing economic value and surplus growth. We employ a strategic asset allocation model, which takes into account the nature of the liabilities and risk tolerances, as well as the risk/return parameters of the various asset classes in which we invest. The model's recommended asset allocation, along with duration and liquidity considerations, guides our initial asset allocation. This is further adjusted based on our analysis of relative value opportunities in different markets. As part of our total return framework, we may sell securities during the period in which fair value has declined below amortized cost for fixed income securities or cost for equity securities. Portfolio performance is measured against outside benchmarks at target allocation weights.

The composition of the investment portfolio at December 31 was:

(in millions)	2004	2003
Bonds	$ 27,250	$ 26,204
Preferred stock	354	376
Common stock	9,377	9,323
Real estate	327	340
Mortgage loans	381	64
Short-term investments	21	647
Other	722	471
Total	$ 38,432	$ 37,425

Total invested assets increased 3%, or $1,007 million, due to positive cash flows from operations and increased unrealized gains on common stock, partially offset by dividends paid to ALCORP. Allstate generally holds its bonds to maturity, but has classified all bonds as available for sale to allow maximum flexibility in portfolio management.

Bonds

Municipal bonds, including tax-exempt and taxable securities, comprise $18.6 billion, or 68.1%, of the bond portfolio at December 31, 2004. Investment grade municipal bonds represent approximately 95.7% of the total with the remainder primarily private placement bonds.

Corporate obligations that are publicly issued totaled $2.96 billion at December 31, 2004 compared to $2.47 billion at December 31, 2003. As of December 31, 2004, the bond portfolio contained $934 million of privately placed corporate obligations, compared with $564 million at December 31, 2003. The benefits of fixed rate privately placed securities when compared to publicly issued securities are generally higher yields, improved cash flow predictability through pro-rata sinking funds, and a combination of covenant and call protection features designed to better protect the holder against losses resulting from credit deterioration, re-investment risk or fluctuations in interest rates. A disadvantage of fixed rate privately placed securities when compared to publicly issued securities is relatively reduced liquidity.

At December 31, 2004 and 2003, $2.85 billion and $2.87 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 subject to interest rate risk since the price volatility and the ultimate realized yield are affected by the rate of prepayment of the underlying mortgages. The current consistently low interest rate environment has resulted in prepayments, which have eroded the prepayment protection in this portfolio over recent years.

The bond portfolio contained $1.39 billion and $1.39 billion of asset-backed securities (“ABS”) at December 31, 2004 and 2003. The ABS portfolio is subject to credit and interest rate risk. Credit risk is managed by monitoring the performance of the collateral. In addition, many of the securities in the ABS portfolio are credit enhanced with features such as over-collateralization, subordinated debt, reserve funds, guarantees and/or insurance. Approximately 84.9% of the ABS portfolio had a Moody’s rating of Aaa or a Standard & Poor’s rating of AAA, the highest rating category. A portion of the ABS portfolio is also subject to interest rate risk since, for example, price volatility and ultimate realized yield are affected by the rate of prepayment of the underlying assets. The ABS portfolio includes collateralized debt obligations and other bonds that are secured by a variety of asset types, predominately credit card receivables, home equity loans, and auto loans.

At December 31, 2004, approximately 94.7% of the bond portfolio was rated investment grade, which is defined as a security having a rating from the NAIC of 1 or 2, a Moody’s equivalent rating of Aaa, Aa, A or Baa, or a comparable internal rating.

The ratings of securities in Allstate's portfolio are influenced by many factors, including the impact of the economic environment on individual securities. The Investment Manager closely monitors its bond portfolio for ratings changes or other declines in value that are other than temporary. Fixed income securities are placed on non-accrual status when they are in default or when the timing or receipt of principal or interest payments are in doubt. Write-downs of bonds are recorded when the decline in value is considered to be other than temporary.

Equity Securities

Equity securities include common and preferred stocks, and investments in affiliates. The increase is attributable to higher unrealized net capital gains during 2004, new money from operations, additional investment in AFIC 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 increased from $64 million at December 31, 2003 to $381 million at December 31, 2004. The increase is a result of Allstate investing in new loans.

Short-Term Investments

The short-term investment portfolio was $21 million and $649 million at December 31, 2004 and 2003, respectively. Allstate invests available cash balances primarily in taxable short-term securities having a final maturity date or redemption date of one year or less.

Allstate also participates 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, 2004, the amount of securities lending collateral reinvested in short-term investments had a carrying value of $686 million. This compares to $298 million at December 31, 2003.

Other Assets

Other invested assets increased $251 million, or 53.3%, from prior year primarily due to the investment in a $175 million surplus note of AFIC. Investment income due and accrued decreased $121 million, or 25.4%, primarily due to a decrease in subsidiary dividends receivable from Allstate Life and Allstate Holdings, Inc. Receivable from parent, subsidiaries and affiliates decreased 63%, or $294 million, due to the re-payment of a loan to ALCORP. Other assets increased $16 million, or 8.5%, 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.

Reserves for Losses and Loss Adjustment Expenses

Activity in the reserve for losses and loss adjustment expenses, on a net basis was summarized as follows at December 31:

(in millions)	2004	2003
Balance at January 1	$ 18,047	$ 18,559
Incurred losses and loss adjustment expense related to:		
Current year	15,251	15,494
Prior years	(225)	473
Total incurred	15,026	15,967
Losses and loss adjustment expenses paid related to:		
Current year	9,311	9,554
Prior years	6,574	6,925
Total paid	15,885	16,479
Balance at December 31	$ 17,188	$ 18,047

Incurred losses and loss adjustment expenses attributable to insured events of prior years were $(225) million and $473 million as a result of the re-estimation of unpaid losses and loss adjustment expenses for the years ending December 31, 2004 and 2003, respectively. For the year ended December 31, 2004 the favorable development in incurred loss and loss adjustment expenses related to the prior years was primarily due to decreases in auto injury severity development that was better than expected and late reported loss development that was better than expected due to lower frequency trends in recent years, partially offset by increases to the asbestos reserves. For the year ended December 31, 2003 the incurred loss and loss adjustment expenses related to prior years was primarily due to higher than expected losses for asbestos exposures partially offset by favorable development in auto liability coverages.

Other Liabilities

Taxes, licenses and fees increased 18%, or $39 million, primarily due to increases in accruals for employee related taxes and guarantee funds. Advance premiums increased 23%, or $59 million, due to changes in policyholder payment patterns representing premiums received prior to the policy effective date. Provision for reinsurance increased 140%, or $98 million, due to the increased reinsurance receivables from unauthorized reinsurers. Payable to parent, subsidiaries and affiliates increased $171 million due to the re-payment of a loan from ALCORP.

Capital and Surplus

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

(in millions)	2004	2003
Common capital stock	$ 4	$ 4
Gross paid in and contributed surplus	2,213	2,166
Unassigned funds (surplus)	14,523	13,876
Aggregate write-ins for special surplus funds	29	57
Total surplus as regards policyholders	$ 16,769	$ 16,103

Total surplus as regards policyholders increased 4%, or $666 million. The increase was primarily due to net income offset by dividends declared to ALCORP and changes in unrealized capital gains.

RESULTS OF OPERATIONS

(in millions)	2004	2003
Premiums earned	$ 23,628	$ 22,525
Losses incurred	12,295	13,292
Loss expenses incurred	2,731	2,675
Other underwriting expenses incurred	6,138	5,733
Total underwriting deductions	21,164	21,700
Net underwriting gain or (loss)	2,464	825
Net investment income earned	2,036	1,772
Net realized capital gains or (losses)	505	272
Net investment gain or (loss)	2,541	2,044
Total other income	286	247
Net income, after dividends to policyholders but before federal and foreign income taxes	5,291	3,116
Federal and foreign income taxes incurred	1,430	389
Net income	$ 3,861	$ 2,727

The increase in underwriting income was the result of increased premiums earned, declines in auto and homeowners claim frequency (rate of claim occurrence) excluding catastrophes and favorable reserve re-estimates related to prior years, partially offset by higher catastrophe losses, increased operating costs and expenses and increased current year claim severity (average cost per claim).

Claims and claims expense during 2004 includes estimated catastrophe losses of $590 million, net of recoveries from the Florida Hurricane Catastrophe Fund, related to hurricanes Charley, Frances, Ivan, and Jeanne. This estimate includes net losses on personal lines auto policies and net losses on commercial policies.

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 2004 and 2003 was lower 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; therefore, we will continue to pursue claim mitigation programs.

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 2004, our rate of increase in incurred physical damage current year claim severity was generally lower than the weighted index. In 2003, our rate of increase in incurred physical damage current year claim severity was generally higher than the weighted index. We believe that results were 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 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, deductibles and other economic and environmental factors. In 2004 and 2003, we experienced an increase in homeowners severity compared to prior year. 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.

The Discontinued Lines and Coverages segment generated underwriting loss of $638 million in 2004 compared to $571 million in 2003. During 2004, the underwriting loss was primarily due to re-estimates of asbestos reserves totaling $463 million, and an increase of $136 million in the allowance for future uncollectible reinsurance. The cost of administering claims settlements totaled $22 million and $23 million for the years ended December 31, 2004 and 2003, respectively.

During 2003, the underwriting loss was also primarily due to our annual review of reserves for asbestos, environmental, and other discontinued lines exposures, resulting in an increase in reserves totaling $514 million, including increases for asbestos of $442 million, $34 million due to new information received for two manufacturing insureds in bankruptcy, and $38 million for an excess insurance policyholder who submitted new and unanticipated claims that were for previously not designated, and therefore unexpected, coverage years.

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, volcanoes, 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.

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 purchase of reinsurance in certain states, restricting the amount and location of new business; limiting the availability of certain policy coverages; placing policies with third parties; and increasing our participation in catastrophe pools. However, the impact of these actions may be diminished by the growth in insured values, 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.

We include catastrophe losses in losses incurred and loss expenses incurred. As a result, catastrophe losses affect both our underwriting results and loss ratios. During 2004, catastrophe losses totaled $1.06 billion, compared to catastrophe losses of $1.48 billion in 2003. Of the $1.06 billion of catastrophe losses incurred during 2004, $590 million related to hurricanes Charley, Frances, Ivan and Jeanne, which struck portions of Florida, the southeastern seaboard, and other parts of the United States.

<u>Pre-tax net investment income</u>
Pre-tax net investment income increased slightly from $1.77 billion in 2003 to $2.04 billion in 2004. The increase was due to higher portfolio balances resulting from positive cash flows from operations and investment activities and higher income from partnerships, partially offset by lower portfolio yields.

<u>After-tax realized capital gains and losses</u>
After-tax realized capital gains and losses were $329 million in 2004 compared to $178 million in 2003. The following table presents the factors driving the realized capital gains and losses results.

(in millions)	**2004**	**2003**
Investment write-downs	$ (20)	$ (57)
Sales	397	239
Valuation of derivative instruments	(48)	(4)
Total after-tax realized capital gains and losses	$ 329	$ 178

The 2003 capital losses were primarily due to $363 million in common stock trading losses and $181 million in net losses on treasury futures.

CASH FLOW AND LIQUIDITY

The following table summarizes cash flow.

(in millions)	**2004**	**2003**
Net cash from operations	$ 4,137	$ 3,513
Net cash from investments	(1,579)	(2,166)
Net cash from financing and miscellaneous sources	(2,086)	(1,581)
Net change in cash and short-term investments	$ 472	$ (234)

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 2004 and 2003 were primarily due to increased underwriting income. In 2004 and 2003, operating cash flows were also impacted by contributions made to our defined benefit pension plans. Cash used in investing activities decreased in 2004 primarily as a result of less underwriting income being available for investment due to higher operating cash flows offset by dividends paid by AIC to its parent.

Financial Ratings and Strength
Allstate's financial strength was rated Aa2, AA and A+ by Moody's, Standard and Poor's and A.M. Best, respectively, at December 31, 2004.

RBC
The NAIC has a standard to help 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, 2004, the RBC for each of our domestic insurance companies was significantly above levels that would require regulatory action.

IRIS Ratios
The NAIC has 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. Additional regulatory scrutiny may occur if a company's 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. All ratios for the Group were within the acceptable limits.

OTHER ITEMS

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

In 1999, AIC along with Allstate New Jersey Insurance Company and Allstate Floridian Insurance Company completed the acquisition of CNA's auto and homeowners personal lines insurance business and re-branded them to Encompass. As part of the acquisition, AIC entered into indemnity reinsurance agreements with CNA's two lead companies, Continental Casualty Company and Continental Insurance Company. The agreements reinsure policy obligations associated with personal insurance policies in-force as of the closing date as well as insurance policies written subsequent to the closing date.