Management's Discussion and Analysis

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Allstate Insurance Group
Combined Management Discussion and Analysis
For the Year Ended December 31, 2005

The Allstate Insurance Group (referred to in this document as "we", "our", "us", "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"), Encompass Indemnity Company ("EI"), Encompass Independent Insurance Company ("EIIC"), Encompass Home and Auto Insurance Company ("EHAIC"), Encompass Insurance Company of America ("EICA"), Encompass Insurance Company of Massachusetts ("EICMA") and Encompass Property and Casualty Company ("EPC"). Since these insurers are part of a consolidated group that utilize 100% intercompany reinsurance agreements, the Company received regulatory approval to prepare a combined Management Discussion and Analysis ("MD&A"). Accordingly, the combined results of the aforementioned companies have been analyzed in this MD&A.

In addition to the affiliated property casualty insurers listed above, Allstate has several unconsolidated subsidiaries, 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. Allstate also has several unconsolidated property casualty insurers, the largest being, Allstate New Jersey Insurance Company ("ANJ") and Allstate Floridian Insurance Company ("AFIC"). These subsidiaries write homeowner and auto business exclusively in New Jersey and Florida, respectively. Separate MD&A's will be filed for Allstate Life, ANJ, AFIC and certain of their subsidiaries.

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 brands of business, the Allstate brand and Encompass brand. Allstate Protection 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 segments 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, our sophisticated risk segmentation process ("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 maintain a broad marketing approach throughout the U.S. 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, unit growth, retention, and sales of Allstate Financial products. We differentiate the Allstate brand from competitors through new innovative products such as Allstate® Your Choice Auto. 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. 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.

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 ("SRM") program, which uses a number of risk evaluation factors including, to the extent legally permissible, insurance scoring based on information that is obtained from credit reports. We continue to expand the number of tiers with successive rating program releases.

Our strategy for the Encompass brand focuses on those markets that give us the best opportunity to grow profitably, in part by using Tiered Pricing.

We are 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 including cost of reinsurance coverage purchased and catastrophe losses, and to pursue other actions affecting our profitability such as improving our underwriting and claims processes.

An important element of our strategy is to manage our property catastrophe exposure to enable us to earn an acceptable return on the risks assumed in our property business and to reduce the variability in our earnings, while providing quality protection to our customers. Although in many areas of the country we are currently achieving returns within acceptable risk tolerances, we continue to seek solutions to improve returns in areas that have known exposure to hurricanes, earthquakes and other catastrophes. We will significantly reduce our catastrophe exposure over time while working to mitigate the impact of our actions on customers. We are also working for changes in the regulatory environment, including fewer restrictions on underwriting, recognizing the need for and improving appropriate risk based pricing and promoting the creation of government sponsored, privately funded solutions. Our property business includes personal homeowners, commercial property and other property lines.

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Pricing of property products 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 and freeze 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, property products are more capital intensive than other personal lines products.

Actions we are taking and evaluation to attain an acceptable catastrophe exposure level in our personal and commercial property businesses include: additional purchases of reinsurance; increased participation in various state facilities such as wind pools; changes in rates, deductibles and coverage; limitations on new business writings; changes to underwriting requirements; non-renewal; discontinuing coverage for certain types of residences; withdrawal from certain markets; and/or pursuing alternative markets for placement of business or segments of risk exposure in certain areas. While actions taken will be primarily focused on reducing the catastrophe exposure in our personal and commercial property businesses, we also consider their impact on our ability to market our auto lines when evaluating the feasibility of their implementation.

In order to assess and monitor our actions, we are considering and adopting new performance measurements for managing our property business. These measurements currently include exposure limits based on hurricane and earthquake losses which have a one percent probability of occurring on an annual aggregate countrywide basis, acceptable targeted rates of return by line and by state and potential exposure to capital impairment.

As part of our catastrophe management efforts, we are involved with a newly created coalition called ProtectingAmerica.org. The coalition is dedicated to raising awareness, educating the public and policymakers, and offering solutions that will better prepare and protect consumers, taxpayers and the American economy from major catastrophes in a sensible, cost-effective fashion. A comprehensive solution is being advanced that includes the development of government sponsored, privately funded catastrophe funds at the state and national levels; improved prevention and mitigation measures, including the adoption of more effective land use policies and stronger building codes; enhanced public education about catastrophe risk; better catastrophe preparedness and response programs and 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. Our exposure to asbestos, environmental and other discontinued lines claims is reported in this segment. We have assigned management of this segment to a designated group of professionals with expertise in claims handling, policy coverage interpretation and exposure identification. As part of its responsibilities, this group is also regularly engaged in policy buybacks, settlements and reinsurance assumed and ceded commutations.

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. Portfolio performance is measured against outside benchmarks at target allocation weights.

As a result of tactical decisions, 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 reviews, which include identifying securities that are other than temporarily impaired and recognizing impairment on securities in an unrealized loss position for which we do not have the intent and ability to hold until recovery, are conducted regularly.

The composition of the investment portfolio at December 31 was:

(in millions)		**2005**			**2004**
Bonds	$	27,605		$	27,250
Preferred stocks		354			354
Common stocks		9,489			9,377
Mortgage loans		507			381
Real estate		279			327
Short-term investments		66			21
Other		875			722
Total	$	39,175		$	38,432

Total invested assets increased 2%, or $743 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 $17.61 billion, or 63.8%, of the bond portfolio at December 31, 2005. The municipal bond portfolio at December 31, 2005 consisted of approximately 5,000 issues from approximately 2,000 issuers.

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Corporate bonds totaled $3.06 billion at December 31, 2005 compared to $2.96 billion at December 31, 2004. As of December 31, 2005, the portfolio contained $1.17 billion of privately placed corporate obligations, compared with $934 million at December 31, 2004. 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.

Mortgage-backed securities ("MBS") totaled $2.58 billion at December 31, 2005, all of which were investment grade. In our MBS portfolio, the credit risk associated with MBS is mitigated due to the fact that the portfolio consists 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 price volatility and the ultimate realized yield are affected by the rate of prepayment of the underlying mortgages.

Asset-backed securities ("ABS") totaled $2.74 billion at December 31, 2005. Our 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 structures, reserve funds, guarantees and/or insurance. Approximately 99.7% of the ABS portfolio had a Moody's rating of Aaa or a Standard & Poor's ("S&P") 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 home equity loans, credit card receivables and auto loans.

At December 31, 2005, 93.5% of the consolidated bond portfolio was rated investment grade, which is defined as a security having a rating from the National Association of Insurance Commissioner's ("NAIC") Securities Valuation Office of 1 or 2; a rating of Aaa, Aa, A or Baa from Moody's or a rating of AAA, AA, A or BBB from S&P, Fitch or Dominion; or a comparable internal rating if an externally provided rating is not available.

Equity Securities

Equity securities include common and non-redeemable preferred stocks, and investments in affiliates. The $112 million increase in common stocks is attributable to higher unrealized net capital gains during 2005, new money from operations, additional investment in AFIC and an increase in the underlying book values of Allstate Life and Allstate Insurance Company of Canada.

Mortgage Loans

Allstate's investment in mortgage loans increased from $381 million at December 31, 2004 to $507 million at December 31, 2005. The increase is a result of Allstate investing in new loans.

Real Estate

The real estate portfolio decreased 15%, or $48 million, due to the sale of several company owned buildings.

Short-Term Investments

The short-term investment portfolio was $66 million and $21 million at December 31, 2005 and 2004, 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 invested in short-term and bond investments, and an offsetting liability is recorded in other liabilities.

Other Invested Assets

Allstate's other invested asset portfolio increased $153 million, or 21%, from prior year primarily due to additional investments in limited partnerships of $124 million.

Other Assets

Reinsurance recoverables from reinsurers increased $77 million, or 85%, due to 3 large claim payments in our discontinued lines and coverage segment. Other more significant changes from the prior year included in Aggregate write-ins for other than invested assets were $50 million in additional company owned life insurance and a $29 million escrow fund established for the potential sale of a company owned property.

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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)		2005		2004
Balance at January 1	$	17,188	$	18,047
Incurred losses and loss adjustment expense related to:				
Current year		19,712		15,251
Prior years		(328)		(225)
Total incurred		19,384		15,967
Losses and loss adjustment expenses paid related to:				
Current year		11,397		9,311
Prior years		6,149		6,574
Total paid		17,546		15,885
Balance at December 31	$	19,026	$	17,188

Incurred losses and loss adjustment expenses attributable to insured events of prior years were $(328) million and $(225) million as a result of the reestimation of unpaid losses and loss adjustment expenses for the years ending December 31, 2005 and 2004, respectively. For the year ended December 31, 2005 the favorable development in incurred loss and loss adjustment expenses related to the prior years was primarily due to net decreases in auto reserves due to auto injury severity development 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 of $139 million. 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 in the asbestos reserves.

Other Liabilities

Borrowed money decreased $309 million, or 46%, due to a decrease in dollar roll transactions during 2005. Advance premiums decreased 34%, or $106 million, due to changes in policyholder payment patterns. A 34% decrease or $57 million, in the provision for reinsurance was due to increased collections from unauthorized reinsurers. Payable to parent, subsidiaries and affiliates increased 192%, or $331 million, mainly due to a payable to ALCORP related to a short-term loan. Aggregate write-ins for liabilities increased $242 million, or 19%, mostly due to increased securities lending transactions.

Capital and Surplus

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

(in millions)		2005		2004
Common capital stock	$	4	$	4
Gross paid in and contributed surplus		2,275		2,213
Unassigned funds (surplus)		12,541		14,523
Aggregate write-ins for special surplus funds		28		29
Total surplus as regards policyholders	$	14,848	$	16,769

Total surplus as regards policyholders decreased 11%, or $1.92 billion. The decrease was primarily due to reduced net income as a result of hurricane activity, offset by dividends declared to ALCORP and changes in unrealized capital gains.

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RESULTS OF OPERATIONS

(in millions)		2005		2004
Premiums earned	$	24,754	$	23,628
Losses incurred		16,010		12,295
Loss expenses incurred		3,374		2,731
Other underwriting expenses incurred		6,203		6,138
Total underwriting deductions		25,587		21,164
Net underwriting gain or (loss)		(833)		2,464
Net investment income earned		2,164		2,036
Net realized capital gains or (losses)		343		505
Net investment gain or (loss)		2,507		2,541
Total other income		226		286
Net income, after dividends to policyholders but before federal and foreign income taxes		1,900		5,291
Federal and foreign income taxes incurred		147		1,430
Net income	$	1,753	$	3,861

The decrease in underwriting income was the result of increased catastrophe losses, lower favorable reserve reestimates related to prior years and increased current year claim severity, partly offset by increased premiums earned, declines in auto and homeowners claim frequency excluding catastrophes and lower operating costs. In 2005, claims and claims expense and the claims and claims expense ratio include the effect of $120 million related to an accrual for a settlement of a worker classification lawsuit challenging our overtime exemption under California wage and hour laws.

Claims and claims expense during 2005 includes estimated catastrophe losses of $5.00 billion, net of reinsurance and other recoveries, related to hurricanes Katrina, Rita and Wilma, and 2004 includes estimated catastrophe losses of $590 million, net of recoveries from the Florida Hurricane Catastrophe Fund ("FHCF"), related to hurricanes Charley, Frances, Ivan, and Jeanne. These estimates include net losses on personal lines auto and property 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 2005 and 2004 was lower than the relevant medical cost indices. For auto physical damage coverages, we monitor our rate of increase in average cost per claim against a weighted average of the Maintenance and Repair price index and the Parts and Equipment price index. In 2005 and 2004, our rate of increase in incurred physical damage current year claim severity was generally lower than the weighted index. 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 to the mitigation of injury and physical damage severity trends.

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 2005 and 2004, 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. 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 $175 million in 2005 compared to $638 million in 2004. During 2005, the underwriting loss was primarily due to reestimates of asbestos reserves totaling $139 million. The cost of administering claims settlements totaled $18 million and $22 million for the years ended December 31, 2005 and 2004, respectively.

During 2004, the underwriting loss was also primarily due to reestimates of asbestos reserves totaling $463 million, and an increase of $136 million in the allowance for future uncollectible reinsurance.

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. Limitations include our participation in various state facilities, such as the CEA, which provides insurance for California earthquake losses; the FHCF, which provides reimbursements on certain qualifying Florida hurricane losses; and other state facilities, such as wind pools. However, the impact of these actions may be diminished by the

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growth in insured values, the effect of state insurance laws and regulations and by the effect of competitive considerations. In addition, in various states we are required to participate in assigned risk plans, reinsurance facilities and joint underwriting associations that provide insurance coverage to individuals or entities that otherwise are unable to purchase such coverage from private insurers. Because of our participation, we may be exposed to losses that surpass the capitalization of these facilities and/or to assessments from these facilities.

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 major metropolitan areas near fault lines in the states of California, Oregon, Washington, South Carolina, Missouri, Kentucky and Tennessee. We include catastrophe losses in losses incurred and loss expenses incurred.

Pre-tax Net Investment Income

Pre-tax net investment income increased from $2.04 billion in 2004 to $2.16 billion in 2005. The increase was due to higher income from partnerships and higher bond portfolio balances resulting from positive cash flows from operations and investment activities, partially offset by lower portfolio yields.

After-tax Realized Capital Gains and Losses

After-tax realized capital gains and losses were $352 million in 2005 compared to $329 million in 2004. The following table presents the factors driving the realized capital gains and losses results.

(in millions)		2005		2004
Investment write-downs	$	(92)	$	(20)
Sales		431		397
Valuation of derivative instruments		13		(48)
Total after-tax realized capital gains (losses)	$	352	$	329

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CASH FLOW AND LIQUIDITY

The following table summarizes cash flow.

(in millions)		2005		2004
Net cash from operations	$	2,940	$	4,137
Net cash from investments		(297)		(1,579)
Net cash from financing and miscellaneous sources		(3,548)		(2,086)
Net change in cash and short-term investments	$	(905)	$	472

The Company's operations typically generate substantial positive cash flows from operations as most premiums are received in advance of the time when claim payments are made. These positive operating cash flows are expected to continue to meet the liquidity requirements of the Company. Lower operating cash flows in 2005 were primarily due to increased claim payments, partially offset by increased premiums and collections of reinsurance and other recoverables related to catastrophes. Claim payments increased as a result of Hurricanes Katrina, Rita and Wilma. Higher operating cash flows of the property-liability business in 2004 were primarily due to increased underwriting income despite catastrophe losses in 2004 and contributions made to our defined benefit pension plans in 2004.

Cash provided by investing activities increased in 2005 primarily as a result of increased proceeds from sales of securities, partially offset by lower operating cash flows and higher dividends paid by AIC to ALCORP. 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 ALCORP.

Cash flows for financing were impacted by dividends paid by AIC to ALCORP totaling $3.86 billion and $2.49 billion in 2005 and 2004, respectively. For a description of limitations on the payment of these dividends, see Note 13 in the AIC Annual Statement. Based on this limitation, without the prior approval from the Illinois Division of Insurance, AIC will not pay dividends to the ALCORP until the third quarter of 2006.

We expect that AIC will have sufficient liquidity to pay estimated catastrophe claims and claims expenses from existing sources of funds including operating cash flows. We expect the loss reserves from Hurricanes Katrina, Rita and Wilma to be paid during 2006.

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, 2005.

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, 2005, 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 a defined usual range. Additional regulatory scrutiny may occur if a company's ratio results fall outside the usual range for four or more ratios. If an insurance company has insufficient capital, regulators may act to reduce the amount of insurance it can issue.

Given that AIC assumes the underwriting results of all insurers comprising the Allstate Insurance Group, AIC's ratio results become a more reliable measurement of overall financial condition than the ratio results of these same individual insurers. At December 31, 2005, AIC had two ratio results that were out of the usual range.