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Allstate Insurance Group
Combined Management Discussion and Analysis
For the Year Ended December 31, 2006

The Allstate Insurance Group (referred to in this document as "we", "our", "us", "Allstate", the "Group" 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 ("APC"), 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, regulatory approval was obtained 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 (the "Corporation"), 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 structured around two brands, 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 includes 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 groupings of financial information that management uses to evaluate performance and to determine the allocation of resources.

ALLSTATE PROTECTION SEGMENT

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 financial products. We differentiate the Allstate brand from competitors by offering a choice of products, including our innovative Allstate® Your Choice Auto ("YCA") with options such as safe driving deductibles and a safe driving bonus, Allstate® Your Choice Homeowners ("YCH") with options such as claims free bonus and personalized coverage and Allstate Blue℠ our new non-standard auto product with features such as loyalty bonuses and roadside assistance, as well as other discount options available depending on a consumer's needs.

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 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.

Substantially all of new and approximately 86% of renewal business written for Allstate brand auto uses Tiered Pricing. For Allstate brand homeowners, approximately 87% of new and 53% of renewal business written uses Tiered Pricing. For Allstate brand auto and homeowners business written under Tiered Pricing, our results indicate a shift toward more customers who we consider high lifetime value that generally are retained longer and have more favorable loss results.

As we continue to use Tiered Pricing, there is a diminishing capacity to draw meaningful comparisons to historical presentations, including the distinctions between standard and non-standard which have become less relevant in certain states. Generally, standard auto customers are expected to have lower risks of loss than non-standard auto customers.

We are pursuing improvements in the overall customer experience through actions targeted to increase customer satisfaction and retention. These programs are designed around establishing customer service expectations and customer relationship building. Our claims strategy focuses on delivering fast, fair and consistent claim service while achieving loss cost management and customer satisfaction.

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 our direct channels: the Internet and call centers.

Our strategy for the Encompass brand includes enhancing pricing and product sophistication through our Tiered Pricing approach Encompass Edge®, increasing distribution effectiveness and improving agency technology interfaces to support profitable growth. We are positioning the brand to expand product breadth and improve agency penetration by leveraging technology and service capabilities.

We continue to pursue our strategy to manage our property catastrophe exposure to provide our shareholders an acceptable return on the risks assumed in our property business and to reduce the variability of our earnings, while providing 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, fires following earthquakes and other catastrophes. Management's measurements for our property business include exposure limits based on hurricane and earthquake losses which have a one percent probability of occurring on an annual aggregate countrywide basis. We are 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. While the actions that we take will be primarily focused on reducing the catastrophe exposure in our property business, we also consider their impact on our ability to market our auto lines.

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.

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 other potential market opportunities available. Portfolio performance is measured against outside benchmarks at target allocation weights.

As a result of tactical decisions, the Company 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 monitoring, which includes 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)	2006	2005
Bonds	$ 28,026	$ 27,606
Preferred stocks	377	354
Common stocks	10,116	9,487
Mortgage loans	648	507
Real estate	299	279
Cash and cash equivalents	66	(386)
Short-term investments	34	66
Other invested assets	1,651	870
Total	$ 41,217	$ 38,783

Total invested assets increased 6%, or $2.4 billion, due to positive cash flows from operations and increased unrealized gains on common stock, partially offset by dividends paid to the Corporation. 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 $16.8 billion, or 60%, of the bond portfolio at December 31, 2006. The municipal bond portfolio at December 31, 2006 consisted of approximately 4,701 issues from approximately 1,925 issuers. The largest exposure to a single issuer was approximately 1% of the municipal bond portfolio. Corporate entities were the ultimate obligors of approximately 9% of the municipal bond portfolio.

Corporate bonds totaled $3.3 billion at December 31, 2006 compared to $3.1 billion at December 31, 2005. As of December 31, 2006, the portfolio also contained $1.5 billion of privately placed corporate obligations, compared with $1.2 billion at December 31, 2005. 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.

Asset-backed securities ("ABS") totaled $3.3 billion at December 31, 2006. 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 structures, reserve funds, guarantees and/or insurance. Approximately 99.8% 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, auto loans and credit card receivables.

Mortgage-backed securities ("MBS") totaled $2.7 billion at December 31, 2006, of which 99.4% were investment grade. The credit risk associated with the MBS portfolio is mitigated due to the fact that it 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. This 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.

At December 31, 2006, 92% 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.

Bonds are carried at amortized cost. The fair value of bonds was $28.9 billion and $28.5 billion at December 31, 2006 and 2005, respectively. At December 31, 2006, unrealized net capital gains on the bond portfolio, which are measured as the difference between statement value and fair value, were $869 million, compared to $906 million as of December 31, 2005.

The ratings of securities in the Company's portfolio are influenced by many factors, including the impact of the economic environment on individual securities. The Investment Manager closely monitors the 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 non-redeemable preferred stocks, and investments in affiliates. The $628 million increase in common stocks was attributable to new money from operations.

Mortgage Loans

Allstate's investment in mortgage loans increased from $507 million at December 31, 2005 to $648 million at December 31, 2006. The increase was a result of Allstate investing in 20 new loans. The Company closely monitors the commercial mortgage loan portfolio on a loan-by-loan basis. Loans with an estimated collateral value less than the loan balance, as well as loans with other characteristics indicative of higher than normal credit risk, are reviewed by management at least quarterly for purposes of establishing valuation allowances and placing loans on non-accrual status. The underlying collateral values are based upon either discounted property cash flow projections or a commonly used valuation method that utilizes a one-year projection of expected annual income divided by an expected rate of return.

Real Estate

The real estate portfolio increased 7%, or $20 million, due to the purchase of one company owned and occupied building and the sale of several company owned and occupied buildings.

Short-term Investments

The short-term investment portfolio was $34 million and $66 million at December 31, 2006 and 2005, 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.

Other Invested Assets

Allstate's other invested asset portfolio increased $781 million, or 90%, from prior year primarily due to additional investments in limited partnerships.

Other Assets

Receivables from parent, subsidiaries and affiliates increased $496 million mainly due to an intercompany loan with Allstate Life. Reinsurance recoverables from reinsurers decreased $81 million, or 48%, due to the receipt of one large claim payment in our discontinued lines and coverage segment. Other noteworthy changes from the prior year included an increase in aggregate write-ins for other than invested assets of $45 million. The major contributors to the increase were $61 million in additional company owned life insurance and a $34 million increase in prepaid reinsurance premium due to new catastrophe contracts, partially offset

by a decrease in accounts receivable of $32 million and a $16 million decrease in an escrow fund established for the potential sale of company owned properties.

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)	2006	2005
Balance at January 1	$ 16,486	$ 14,177
Incurred related to:		
Current year	15,508	19,712
Prior years	(748)	(328)
Total incurred	14,760	19,384
Paid related to:		
Current year	9,697	11,397
Prior years	7,203	5,678
Total paid	16,900	17,075
Balance at December 31	$ 14,346	$ 16,486

Incurred losses and loss adjustment expenses attributable to insured events of prior years were $(748) million and $(328) million as a result of the reestimation of unpaid losses and loss adjustment expenses for the years ending December 31, 2006 and 2005, respectively. During 2006, incurred losses and loss adjustment expenses related to prior years were primarily composed of net decreases in auto reserves due to claim severity development and late reported loss development that was better than expected due to lower frequency trends in recent years, offset by increases in asbestos reserves of $86 million. Incurred losses and loss adjustment expenses related to prior years also included favorable catastrophe loss reserve reestimates of $132 million net of recoveries for the 2005 and 2004 hurricanes, primarily related to lower than expected claim severity for Hurricane Katrina and $6 million related to a reduction of the expected assessment from FL Citizens. During 2005, incurred losses and loss adjustment expenses related to prior years were primarily composed of 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, and increases in asbestos reserves of $139 million. Incurred losses and loss adjustment expenses related to prior years also included $16 million of property losses related to 2004 hurricanes, of which $5 million was a FL Citizens assessment that was accruable in 2005.

Other Liabilities

Borrowed money decreased $304 million, or 85%, due to a decrease in dollar roll transactions during 2006. Advance premiums increased 14%, or $29 million, based on changes in policyholder payment patterns. A 39%, or $44 million, increase in the provision for reinsurance was due to two large claim settlements for which the recoverables were over 90 days past due. Payable to parent, subsidiaries and affiliates decreased 61%, or $309 million, mainly due to repayment of a loan from the Corporation. Aggregate write-ins for liabilities also increased $278 million, or 14%, and was almost entirely 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)	2006	2005
Common capital stock	$ 4	$ 4
Gross paid in and contributed surplus	2,328	2,275
Unassigned funds (surplus)	16,768	12,536
Aggregate write-ins for special surplus funds	41	28
Total surplus as regards policyholders	$ 19,141	$ 14,843

Total surplus as regards policyholders increased 29%, or $4.3 billion. The increase was primarily due to increased net income resulting from a return to more favorable hurricane loss experience and greatly improved underwriting results, partially offset by dividends declared to the Corporation.

RESULTS OF OPERATIONS

(in millions)		2006		2005
Premiums earned	$	25,078	$	24,754
Losses incurred		11,889		16,010
Loss expenses incurred		2,870		3,374
Other underwriting expenses incurred		6,453		6,203
Total underwriting deductions		21,212		25,587
Net underwriting gain or (loss)		3,866		(833)
Net investment income earned		2,535		2,165
Net realized capital gains or (losses)		108		343
Net investment gain or (loss)		2,643		2,508
Total other income		245		226
Net income, after dividends to policyholders but before federal and foreign income taxes		6,754		1,901
Federal and foreign income taxes incurred		1,814		147
Net income	$	4,940	$	1,754

The increase in underwriting income was the result lower catastrophe losses, increased premiums earned, declines in auto and homeowners claim frequency excluding catastrophes and higher favorable reserve reestimates related to prior years including $132 million of favorable development relating to catastrophe losses, partially offset by the higher cost of the catastrophe reinsurance program and increased current year severity.

In 2005, claims and claims expense included 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 included estimated catastrophe losses of $5 billion, net of reinsurance and other recoveries, related to hurricanes Katrina, Rita and Wilma. These estimates included net losses on personal lines auto and property policies and net losses on commercial policies.

The Discontinued Lines and Coverages segment generated an underwriting loss of $139 million in 2006 primarily related to an $86 million reestimate of asbestos reserves. Also contributing to the 2006 underwriting loss was a $10 million reestimate of environmental reserves and a $26 million increase in the allowance for future uncollectible reinsurance recoverables. The cost of administering claims settlements totaled $19 million and $18 million for the years ended December 31, 2006 and 2005, respectively.

During 2005, the underwriting loss was primarily due to reestimates of asbestos reserves totaling $139 million.

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 pretax 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 certain 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 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. Due to our participation in these and other state facilities such as wind pools, we may be exposed to losses that surpass the capitalization of these facilities and/or to assessments from these facilities.

Actions we have taken or are considering to attain an acceptable catastrophe exposure level in our property business include:

- removing wind coverage from certain policies and allowing our agencies to help customers apply for wind coverage through state facilities such as wind pools
- changes in rates, deductibles and coverage
- limitations on new business writings
- changes to underwriting requirements, including limitations in coastal and adjacent counties
- not offering continuing coverage to some existing policyholders
- purchasing reinsurance or engaging in other forms of risk transfer arrangements
- discontinuing coverage for certain types of residences
- withdrawing from certain geographic markets

In the normal course of business, we may supplement our claims processes by utilizing third party adjusters, appraisers, engineers, inspectors, other professionals and information sources to assess and settle catastrophe and non-catastrophe related claims. For example, our longstanding contract with Pilot Catastrophe Services ("Pilot") for additional claims adjusters contributes to our ability to complete more timely settlement of catastrophe claims.

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 $2.2 billion in 2005 to $2.5 billion in 2006. The increase was primarily 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.

CASH FLOW AND LIQUIDITY

The following table summarizes cash flow.

(in millions)	2006	2005
Net cash from operations	3,277	2,941
Net cash from investments	(1,227)	(193)
Net cash from financing and miscellaneous sources	(1,630)	(3,560)
Net change in cash, cash equivalents and short-term investments	$ 420	$ (812)

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. Improved operating cash flows in 2006 were primarily due to increased premium collection and increased investment income.

Lower operating cash flows in 2005 were mainly 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.

Cash used in investing activities increased in 2006 primarily as a result of more underwriting income being available for investment due to higher operating cash flows, offset by dividends paid by AIC to the Corporation. 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 the Corporation.

Cash flows from financing were impacted by dividends paid by AIC to the Corporation totaling $1.0 billion and $3.9 billion in 2006 and 2005, respectively.

Financial Ratings and Strength

Allstate's financial strength was rated Aa2, AA and A+ by Moody's, S&P and A.M. Best, respectively, at December 31, 2006.

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, 2006, the RBC for each of the insurers comprising the Group 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 a defined usual range. Additional regulatory scrutiny may occur if a company's ratio results fall outside the usual range 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. At December 31, 2006, AIC had two ratio results that were out of the usual range.