

NAIC Group Code 0008  
NAIC Company Code 60186  
Employer's ID Number 36-2554642

**Allstate Life Insurance Group  
Combined Management Discussion and Analysis  
For the Year Ended December 31, 2010**

The Allstate Life Insurance Group ("Company") consists of Allstate Life Insurance Company ("ALIC"), Allstate Life Insurance Company of New York ("ALNY"), Lincoln Benefit Life Company ("LBL"), Surety Life Insurance Company ("Surety"), Charter National Life Insurance Company ("CNLIC"), Intramerica Life Insurance Company ("ILIC"), Allstate Assurance Company ("AAC") and ALIC Reinsurance Company ("ALIC Re"). Regulatory approval was received 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.

ALIC, the lead company, is a wholly-owned subsidiary of Allstate Insurance Company ("AIC") and an Illinois domiciled insurer. AIC is a wholly-owned subsidiary of Allstate Insurance Holdings, LLC ("AIH"), a Delaware limited liability company. AIH is a wholly-owned subsidiary of The Allstate Corporation ("Corporation").

The Company is licensed to conduct business in all states, the District of Columbia, Guam, Puerto Rico and the U.S. Virgin Islands. The Company provides life insurance, retirement and investment products, and voluntary accident and health insurance products to customers. Its products include fixed annuities, including deferred and immediate annuities, interest-sensitive, traditional and variable life insurance, voluntary accident and health insurance and funding agreements backing medium-term notes ("MTNs"). Products are sold through a wide range of distribution channels, including Allstate exclusive agencies, which include exclusive financial specialists, independent agents (including master brokerage agencies), and specialized structured settlement brokers.

## **FINANCIAL POSITION**

### **Cash and invested assets**

An important component of the Company's financial results is the return on the investment portfolio. The investment portfolio is managed based upon the nature of the business and its corresponding liability structure.

A strategic asset allocation approach is employed, using models that consider the nature of its liabilities and risk tolerances, as well as the risk and return parameters of the various asset classes in which it invests. This asset allocation is informed by the global economic and market outlook, as well as other inputs and constraints, including diversification effects, duration, liquidity and capital considerations. The Company continues to manage risks associated with rising interest rates and commercial real estate.

The Company's investment strategy focuses on the total return of assets needed to support its underlying liabilities and to achieve an appropriate return on capital. Within the ranges set by the strategic asset allocation model, tactical investment decisions are made in consideration of prevailing market conditions. There is continued focus on strategic risk mitigation efforts towards managing interest rate, credit and real estate investment risks, while the return optimization efforts focus on investing in market opportunities to generate income and capital appreciation.

The Company has a comprehensive portfolio monitoring process to identify and evaluate each security whose carrying values may be other-than-temporarily impaired. The portfolio monitoring process includes a quarterly review of all securities through a screening process which identifies instances where the fair value compared to amortized cost (for bonds, including loan-backed and structured securities) and cost (for stocks) is below established thresholds, and also includes the monitoring of other criteria such as ratings and payment defaults.

The composition of the investment portfolio at December 31 was:

(in millions)	<u>2010</u>		<u>2009</u>	
Bonds	\$	47,186	\$	49,429
Preferred stocks		64		69
Common stocks		184		167
Mortgage loans on real estate		6,405		7,514
Cash and cash equivalents		1,109		1,423
Short-term investments		87		180
Contract loans		843		826
Other invested assets		1,767		1,411
Other		511		675
<b>Total</b>	<b>\$</b>	<b>58,156</b>	<b>\$</b>	<b>61,694</b>

Total invested assets decreased \$3.54 billion, or 6%, at December 31, 2010 and was primarily due to negative cash from operations, net withdrawals on deposit-type contracts and net realized capital losses on investments, partially offset by unrealized gains on invested assets.

### **Bonds**

The bond portfolio consists of corporate bonds including privately placed securities, mortgage-backed securities ("MBS"), U.S. government bonds, tax-exempt and taxable municipal bonds, asset-backed securities ("ABS") and foreign government bonds.

At December 31, 2010, 91% of the consolidated bond portfolio was rated investment grade, which is defined as a security having a National Association of Insurance Commissioners ("NAIC") Securities Valuation Office rating of 1 or 2; a Moody's rating of Aaa, Aa, A, or Baa, a S&P, Fitch, Dominion, or Realpoint rating of AAA, AA, A or BBB; an A.M. Best rating of aaa, aa, a, or bbb; or a comparable internal rating if an externally provided rating is not available. The most significant change in the bond portfolio mix from the prior year occurred in the MBS portfolio which decreased \$2.02 billion. This decrease was primarily due to the payments for maturing funding agreements, portfolio risk reduction and yield enhancement. There was no significant change in the bond portfolio quality distribution from the prior year.

Bonds with an NAIC designation of 1 through 5, including bank loans, which are primarily senior secured corporate loans, loan-backed and other structured securities, are stated at amortized cost using the scientific interest method. Bonds with an NAIC designation of 6 are carried at the lower of amortized cost or fair value, with the difference reflected in unassigned surplus. The fair value of bonds was \$48.19 billion and \$47.70 billion at December 31, 2010 and 2009, respectively. Unrealized net capital gains on the bond portfolio, which are calculated as the difference between statement value and fair value, were \$1.01 billion as of December 31, 2010 compared to unrealized net losses of \$1.74 billion as of December 31, 2009.

Corporate bonds totaled \$26.57 billion and \$27.18 billion at December 31, 2010 and 2009, respectively. As of December 31, 2010, the portfolio also contained \$11.93 billion of privately placed corporate obligations compared with \$13.03 billion at December 31, 2009. The benefits of privately placed securities as compared to public securities are improved cash flow predictability through pro-rata sinking funds on many bonds, and a combination of covenant and call protection features designed to better protect the holder against losses resulting from credit deterioration, reinvestment risk and fluctuations in interest rates. A potential disadvantage of privately placed securities as compared to public securities is reduced liquidity. 88% of the privately placed securities were rated investment grade by either the NAIC or internal ratings.

At December 31, 2010 and 2009, \$6.53 billion and \$8.55 billion, respectively, of the bond portfolio were invested in MBS. The MBS portfolio consists primarily of securities which were issued by or have underlying collateral that is guaranteed by U.S. government agencies or sponsored entities, thus minimizing credit risk. The MBS portfolio, however, is subject to interest rate risk since price volatility and ultimate realized yield are affected by the rate of repayment of the underlying mortgages. The Company attempts to limit interest rate risk on these securities by investing a portion of the portfolio in securities that provide prepayment protection. At December 31, 2010, 83% of the MBS portfolio was rated investment grade.

The bond portfolio also contained \$3.72 billion and \$3.31 billion of ABS at December 31, 2010 and 2009, respectively. The ABS portfolio is subject to credit and interest rate risks. Credit risk is mitigated 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. 78% of the ABS securities were rated investment grade by either the NAIC or internal ratings. Interest rate risk is similar to the risk posed by MBS, but to a lesser degree due to the nature of the underlying assets.

The Company had exposure to subprime residential mortgage related risk in the form of asset-backed residential mortgage-backed securities ("ABS RMBS") and asset-backed collateralized debt obligations ("ABS CDO"). The ABS RMBS portfolio includes securities that are collateralized by mortgage loans issued to borrowers that cannot qualify for prime or alternative financing terms due in part to an impaired or limited credit history. It also includes securities that are collateralized by certain second lien mortgages regardless of the borrower's credit profile. The ABS CDO portfolio contains securities collateralized by a variety of residential mortgage-backed and other securities, which may include subprime residential mortgage-backed securities. At December 31, 2010, the ABS RMBS portfolio had net unrealized losses of \$267 million, of which all but \$4 million were gross unrealized losses. At December 31, 2009, the ABS RMBS portfolio had net unrealized losses of \$530 million, of which all but \$1 million were gross unrealized losses.

Municipal bonds, including tax-exempt and taxable securities, totaled \$4.56 billion at December 31, 2010 compared to \$4.91 billion at December 31, 2009. 98% of these securities were rated investment grade at December 31, 2010.

Fixed income securities issued by the U.S. government and agencies of the U.S. government totaled \$4.64 billion at December 31, 2010 compared to \$4.52 billion at December 31, 2009. All of these securities were rated investment grade at December 31, 2010.

#### **Mortgage loans on real estate**

Mortgage loans on real estate decreased \$1.11 billion to \$6.41 billion at December 31, 2010 primarily due to the Company's risk mitigation efforts of reducing real estate exposure to adapt to current market conditions. Mortgage loans are collateralized by first mortgages on developed commercial real estate. Geographical and property type diversification are key considerations used to manage exposure.

Mortgage loans are evaluated for impairment on a specific loan basis through a quarterly credit monitoring process and review of key credit quality indicators. Mortgage loans are considered impaired when it is probable that the Company will not collect the contractual principal and interest. Valuation allowances are established for impaired loans to reduce the carrying value to the fair value of the collateral less costs to sell or the present value of the loan's expected future repayment cash flows discounted at the loan's original effective interest rate. The Company recorded \$64 million and \$85 million of realized capital losses related to other-than-temporary impairments on mortgage loans for the year ended December 31, 2010 and 2009, respectively. For the years ended December 31, 2010 and 2009, the Company reported zero and \$90 million, respectively, in valuation allowances on mortgage loans.

#### **Other invested assets**

Other invested assets increased \$356 million to \$1.77 billion at December 31, 2010 mostly attributed to limited partnerships and low income housing credits due to additional funding and an increase in valuation.

#### **From Separate Accounts**

Separate Accounts balances decreased by \$362 million, or 4%, to \$8.99 billion at December 31, 2010 due in large part to the lower investment income and premium. The decrease in premium was primarily due to the transfer of market value adjusted annuities ("MVAA") assets to the ALIC General Account in the 4<sup>th</sup> quarter of 2009.

The assets of the Separate Accounts are carried at fair value. Separate Accounts liabilities represent the contractholders' claims to the related assets and are carried at the fair value of the assets. In the event the asset values of certain contractholder accounts are projected to be below the value guaranteed by the Company, a liability is established through a charge to earnings. Reserves for guarantees provided by the Company are included in Exhibit 5 of the Company's General Account annual statement.

The Company issues deferred variable annuities and variable life contracts, the assets and liabilities of which are legally insulated and recorded as assets and liabilities of the Separate Accounts. Absent any contract provision wherein the Company provides a guarantee, the contractholders of the variable annuity and variable life products bear the investment risk that the Separate Accounts funds may not meet their stated investment objectives. The Company began to issue registered deferred annuity contracts in 2010. The assets and liabilities of registered deferred annuity contracts are also recorded as assets and liabilities of the Separate Accounts, however they are not legally insulated from the General Account.

**Aggregate reserve for life contracts**

(in millions)	<u>2010</u>	<u>2009</u>
Fixed annuities	\$ 17,305	\$ 19,115
Interest sensitive life	9,751	9,230
Structured settlements	6,963	6,885
MVAA	5,911	6,936
Indexed annuities	4,478	4,257
Traditional	1,637	1,531
Annuity buy outs	881	923
Single premium immediate annuities	596	629
Payout annuities	512	470
Other	218	181
Total	<u>\$ 48,252</u>	<u>\$ 50,157</u>

Aggregate reserves decreased \$1.91 billion to \$48.25 billion as of December 31, 2010 compared to \$50.16 billion as of December 31, 2009. The decrease was primarily driven by decreases in fixed annuities reserves and MVAA reserves of \$1.81 billion and \$1.02 billion, respectively, primarily due to the Company's strategic approach to reduce exposure to spread-based products. The decreases were partially offset by the increase in reserves for interest sensitive life, indexed annuities and traditional life.

**Liability for deposit-type contracts**

The liability for deposit-type contracts decreased \$1.85 billion to \$6.26 billion as of December 31, 2010 compared to \$8.11 billion as of December 31, 2009. The majority of the decrease was driven by payments for maturing funding agreements.

**Net adjustment in assets and liabilities due to foreign exchanges rates**

Net adjustment in assets and liabilities due to foreign exchange rates decreased \$171 million to \$33 million as of December 31, 2010 compared to \$204 million as of December 31, 2009. The decrease was mainly attributed to exposure to the British pound sterling ("GBP") and the Swiss franc ("CHF") foreign exchange rates related to funding agreement liabilities, driven by the devaluation in GBP and CHF against the United States dollar.

**Capital and surplus**

Capital and surplus decreased \$112 million to \$3.49 billion. The decrease was mainly due to the current year net loss of \$457 million, partially offset by \$241 million in net unrealized capital gains and an \$88 million decrease in nonadmitted assets. The increase in net unrealized capital gains was mostly attributed to bonds.

## RESULTS OF OPERATIONS

(in millions)	<u>2010</u>	<u>2009</u>
Premiums and annuity considerations	\$ 2,787	\$ 3,736
Net investment income including IMR amortization	2,704	2,379
Commissions and expense allowances	164	191
Reserve adjustments on reinsurance ceded	(1,244)	(1,118)
Income from fees	67	71
Other income	9	8
Total revenue	<u>4,487</u>	<u>5,267</u>
Provision for benefits	4,937	15,255
Commissions and general insurance expenses	792	843
Insurance taxes, licenses and fees	64	64
Net transfers to or (from) Separate Accounts	<u>(1,223)</u>	<u>(10,446)</u>
Total expense	<u>4,570</u>	<u>5,716</u>
Net gain from operations before dividends to policyholders and federal income taxes	(83)	(449)
Federal and foreign income taxes incurred	<u>(135)</u>	<u>(449)</u>
Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains (losses)	52	-
Realized gains (losses), net of IMR and federal income taxes	<u>(509)</u>	<u>(929)</u>
Net income	<u>\$ (457)</u>	<u>\$ (929)</u>

### **Net income**

The net loss of \$457 million at December 31, 2010 consisted mostly of net realized capital losses, net of IMR and federal income taxes. Net gain from operations after dividends to policyholders and federal income taxes and before realized capital losses increased \$52 million primarily due to reduced benefits and expenses, partially offset by reduced revenue.

### **Premiums and annuity considerations**

Premiums and annuity considerations decreased \$949 million, or 25%, due in large part to decreases in MVAAs of \$671 million and fixed annuities of \$281 million. MVAA and fixed annuities sales decreased primarily due to the Company's strategy to reduce exposure to spread-based products.

### **Net investment income**

Net investment income, including interest maintenance reserve ("IMR") amortization, increased \$325 million, or 14%. Net investment income increased \$265 million primarily due to an increase in the average investment yield.

### **Provision for benefits**

Provision for benefits decreased \$10.32 billion, or 68%, and was largely attributed to the decrease in aggregate reserves for life and accident and health contracts. The decrease in reserves was mostly comprised of \$7.96 billion in MVAA, \$2.01 billion in fixed annuities and \$0.34 billion in indexed annuities. The MVAA decrease was primarily driven by the transfer of MVAAs from the Separate Account in the 4<sup>th</sup> quarter of 2009. The decreases related to fixed annuities and indexed annuities were mostly caused by lower premiums and higher surrenders.

### **Net transfers from Separate Accounts**

The transfers from Separate Accounts decreased \$9.22 billion in 2010, primarily due to the transfer of the MVAAs to the General Account in the 4<sup>th</sup> quarter of 2009.

### **Net realized capital losses**

Net realized capital losses decreased \$420 million, or 45%, due to lower impairment writedowns of bonds and other invested assets.

## CASH FLOW AND LIQUIDITY

The following table summarizes cash flow.

(in millions)	2010	2009
Net cash from operations	\$ (1,000)	\$ 7,597
Net cash from investments	2,854	(5,540)
Net cash from financing and miscellaneous sources	(2,261)	(4,248)
Net change in cash, cash equivalents and short-term investments	\$ (407)	\$ (2,191)

The principal sources of cash flows from operations were premiums, investment income, net transfers from Separate Accounts and federal income tax recovered. The principal uses were the payment of claims and related expenses, and commissions and operating expenses.

The net cash from investments was primarily attributed to bonds. The maturity structure of the Company's bonds, which represent 81% of the Company's total investments, is managed to meet the anticipated cash flow requirements of the underlying liabilities. A portion of the diversified product portfolio, primarily fixed deferred annuities and universal life insurance policies, is subject to discretionary surrender and withdrawal by customers.

The most significant component of the negative cash flows from financing and miscellaneous sources was net withdrawals on deposit-type contracts of \$2.12 billion, primarily due to scheduled distributions of MTN contracts.

Liquidity for life insurance companies is measured by the ability to pay contractual benefits and operating expenses, and fund investment commitments. Annuity reserves at December 31, 2010, excluding Separate Accounts, comprise 78% of total reserves in-force. Of the total annuity reserves, \$16.20 billion, or 36%, are not subject to discretionary withdrawal. The Company maintains a strong liquidity position and is well positioned to meet its policyholders' obligations.

### **Financial strength ratings and outlook**

The Company's financial strength ratings and outlook were A+ (negative), A+ (negative) and A1 (stable) by A.M. Best, Standard & Poor's and Moody's, respectively, at December 31, 2010.

### **Risk based capital**

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 factors relating to insurance, business, asset and interest rate risks. At December 31, 2010, RBC for each of the insurers comprising the Company 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 to assist state regulators in monitoring the financial condition of insurance 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 range. Additional regulatory scrutiny may occur if a company's ratio results fall outside the usual range for four or more ratios. At December 31, 2010, 4 of the 8 insurers comprising the Company had at least one ratio that was out of the usual range. The Company is not currently under additional regulatory scrutiny based on these ratio results.

## OTHER

The Company's reinsurance ceded on life insurance in-force decreased \$14.26 billion to \$237.63 billion at December 31, 2010 compared to \$251.89 billion at December 31, 2009. The Company purchases reinsurance to limit aggregate and single losses on large risks, while retaining primary liability as a direct insurer for all risks ceded to reinsurers.

ALIC's insurance subsidiaries are domiciled in Illinois, Nebraska, New York and South Carolina. The IL and NE domiciled insurance subsidiaries have a 100% intercompany reinsurance agreement in place with ALIC.

As of both December 31, 2010 and 2009, 45% and 47%, respectively of the Company's face amount of life insurance in-force was reinsured. The Company also cedes substantially all of the risk associated with variable annuity contracts and 100% of the morbidity risk on substantially all of the long-term care contracts to non-affiliates.

The credit worthiness of external reinsurers is continuously monitored. As of December 31, 2010, 92% of ceded premiums under uncollateralized non-affiliate reinsurance treaties were ceded to companies that currently have an A.M. Best financial strength rating of A- or better.