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Allstate Insurance Group
Combined Management Discussion and Analysis
For the Year Ended December 31, 2011

OVERVIEW

The Allstate Insurance Group (referred to as the "Group") consists of Allstate Insurance Company ("AIC"), Allstate Indemnity Company, Allstate Texas Lloyd's, Allstate Vehicle and Property Insurance Company, Allstate Property and Casualty Insurance Company, Allstate County Mutual Insurance Company, Allstate Fire and Casualty Insurance Company, Northbrook Indemnity Company, Allstate North American Insurance Company, Encompass Insurance Company, Encompass Indemnity Company, Encompass Independent Insurance Company, Encompass Home and Auto Insurance Company, Encompass Insurance Company of America, Encompass Insurance Company of Massachusetts, Encompass Property and Casualty Company and North Light Specialty Insurance Company. 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-liability insurers listed above, the Group 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. There are also several unconsolidated property and casualty insurers, the two largest being Allstate New Jersey Insurance Company ("ANJ") and Castle Key Insurance Company ("CKIC"). ANJ writes auto and homeowners exclusively in New Jersey, while CKIC writes only homeowners in Florida. The Group also has an affiliated foreign insurer, Allstate Insurance Company of Canada, which has three subsidiary insurance companies. Separate MD&As were filed for Allstate Life and certain of its subsidiaries, ANJ and CKIC.

AIC is an Illinois domiciled insurer licensed to write property and casualty business in 50 states, the District of Columbia, and Puerto Rico and offers a broad range of personal and commercial insurance products. Allstate Insurance Holdings, LLC ("Allstate Holdings"), a Delaware Corporation, owns all of AIC's outstanding shares of common stock and is wholly-owned by The Allstate Corporation ("Corporation").

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 the Group's results of operations and financial position. The Group defines 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 high winds, winter storms, tornadoes, hailstorms, wildfires, tropical storms, hurricanes, earthquakes and volcanoes. The Group is also exposed to man-made catastrophic events, such as certain types of terrorism or industrial accidents. The nature and level of catastrophes in any period cannot be predicted.

Over time the Group has limited its aggregate insurance exposure to catastrophe losses in certain regions of the country that are subject to high levels of natural catastrophes. Limitations include participation in various state facilities, such as the California Earthquake Authority, which provides insurance for California earthquake losses; the Florida Hurricane Catastrophe Fund, which provides reimbursements to participating insurers for 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, and the effect of state insurance laws and regulations. In addition, in various states the Group is 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 the Group's participation in these and other state facilities such as wind pools, it may be exposed to losses that surpass the capitalization of these facilities and to assessments from these facilities.

The Group continues to take actions to maintain an appropriate level of exposure to catastrophic events while continuing to meet customer's needs, including the following:

- Selectively not offering continuing coverage of mono-line homowners policies in coastal areas of certain states.
- Increased capacity in the brokerage platform for customers not offered a renewal.
- Expanded the Group's excess and surplus carrier to eight new states in 2011, bringing the total number of active states to 25.
- In Texas wind exposure related to insured property located in wind pool eligible areas along the coast including the Galveston Islands is being ceded.
- No writing of new homeowners business in California.

Property catastrophe exposure management includes purchasing reinsurance to provide coverage for known exposure to hurricanes, earthquakes, wildfires, fires following earthquake and other catastrophes. The Group is working for changes in the regulatory environment, including recognizing the need for better catastrophe preparedness, improving appropriate risk based pricing and promoting the creation of government sponsored, privately funded solutions for mega-catastrophes that will make insurance more available and affordable. While the actions that the Group takes will be primarily focused on reducing the catastrophe exposure in our property business, the Group also considers their impact on the ability to market auto lines.

The Group considers the greatest areas of potential catastrophe losses due to hurricanes generally to be major metropolitan centers in counties along the eastern and gulf coasts of the United States. Usually, the average premium on a property policy near these coasts is greater than in other areas. However, average premiums are often not considered commensurate with the inherent risk of loss. In addition, in various states the Group is subject to assessments from assigned risk plans, reinsurance facilities and joint underwriting associations providing insurance for wind related property losses.

The Group has addressed its risk of hurricane loss by, among other actions, purchasing reinsurance for specific states and on a countrywide basis for its personal lines property insurance in areas most exposed to hurricanes; limiting personal homeowners new business writings in coastal areas in southern and eastern states; implementing tropical cyclone deductibles were appropriate; and not offering continuing coverage on certain policies in coastal counties in certain states. The Group continues to seek appropriate returns for its risks. This may require further actions, similar to those already taken, in geographies where the Group is not getting appropriate returns. However, the Group may maintain or opportunistically increase its presence in areas where the Group achieves adequate returns and does not materially increase its hurricane risk.

Effective November 30, 2011, the Corporation replaced AIC as sponsor of the Group's defined benefit pension plans.

BUSINESS SEGMENTS

The Group's property-liability operations consist of two reporting segments: Allstate Protection and Discontinued Lines and Coverages. Allstate Protection comprises three brands: Allstate, Encompass and Esurance. 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 the Group no longer writes 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.

The Allstate brand utilizes marketing delivered to target customers to promote the Group's strategic priorities, with messaging that continues to communicate affordability and the ease of doing business with the Group, as well as the importance of having proper coverage by highlighting the comprehensive product and coverage options.

The Allstate brand is differentiated from competitors by offering a comprehensive range of innovative product options and features as well as product customization, including Allstate Your Choice Auto® with options such as accident forgiveness, safe driving deductible rewards and a safe driving bonus. The Group will continue to focus on developing and introducing products and services that benefit today's consumers and further differentiate the Group and enhance the customer experience. The Company will deepen customer relationships through value-added customer interactions and expanding its presence in households with multiple products by providing financial protection for customer needs. In addition, a claim satisfaction guarantee was introduced that promises a return of premium to any Allstate brand standard auto insurance customer dissatisfied with their claims experience, which differentiates the Group from the competition.

Within the Group's multiple distribution channels the Group is undergoing a focused effort to enhance capabilities by implementing uniform processes and standards to elevate the level and consistency of the Group's customers experience.

The Group continues to enhance technology to integrate 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 its distribution and service channels by increasing the productivity of the Allstate brand's exclusive agencies. Beginning in 2012, Allstate brand direct sales and service will focus on serving customers who prefer personal advice and assistance and work closer with the Group's exclusive agents.

The Group's pricing and underwriting strategies and decisions, made in conjunction within a program called Strategic Risk Management, are designed to enhance both the Group's competitive position and the profit potential. Pricing sophistication, which underlies the Group's Strategic Risk Management program, uses a number of risk evaluation factors including insurance scoring, to the extent permissible by regulations, based on information that is obtained from credit reports. The Group's auto risk evaluation pricing model was implemented for 25 states in 2011 and these implementations will continue in other states throughout 2012. The Group's pricing strategy involves marketplace pricing and underwriting decisions that are based on these risk evaluation models and an evaluation of competitors. The Group will utilize pricing sophistication to increase price competiveness to a greater share of target customers. This process is called optimization and it includes underwriting information, pricing and discounts to achieve a higher close rate.

The Group will also continue to provide a range of discounts to attract more target customers. For Allstate brand auto and homeowners business, the Group continues to improve its mix of customers towards those customers that have better retention and thus potentially present more favorable prospects for profitability over the course of their relationships with the Group. For homeowners, the Group will address rate adequacy and improve underwriting and claim effectiveness. A comprehensive strategic review of our homeowners insurance business is ongoing.

The Allstate Protection segment also includes a separate organization called Emerging Businesses which comprises Business Insurance (commercial products for small business owners), Consumer Household (specialty products including motorcycles, boats, renters and condominium insurance policies), Allstate Dealer Services (insurance and non-insurance products sold primarily to auto dealers), Allstate Roadside Services (retail and wholesale roadside assistance products) and Ivantage (insurance agency). The Group expects we will continue to accelerate profitable growth in Emerging Businesses during 2012.

The Group's strategy for the Encompass brand includes enhancing the Premier Package Policy (providing customers with the ability to simplify their insurance needs by consolidating their coverage into one policy, with one bill, one premium and one renewal date) to appeal to customers with broad personal lines coverage needs and that value an independent agent. Additionally, Encompass is focused on increasing distribution effectiveness and improving agency technology interfaces to become the package carrier of choice for aligned agencies to generate stable, consistent earnings growth.

Pricing of property products is typically intended to establish returns that are deemed 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 the 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 that were incorporated into the products' pricing. The Group pursues rate increases where indicated using a newly re-designed methodology that appropriately addresses the changing costs of losses from catastrophes such as severe weather and the net cost of reinsurance.

FINANCIAL POSITION

Cash and invested assets

The Group's investment strategy emphasizes safety of principal and consistent income generation, within a total return framework. This approach is designed to produce competitive returns over time, and to ensure financial strength and stability for paying claims, while maximizing economic value and surplus growth. A strategic asset allocation model is employed, which considers the nature of the liabilities and risk tolerances, as well as the risk and return parameters of the various asset classes in which the Group invests. The model's recommended asset allocation, along with duration and liquidity considerations, guides the Group's initial asset allocation. This is further adjusted based on an analysis of other potential market opportunities available. Portfolio performance is measured against income targets, with performance relative to benchmarks a secondary consideration.

The Group's portfolio monitoring process includes a quarterly review of all securities to identify instances where the fair value of a security compared to its amortized cost (for bonds, including loan-backed and structured securities) or cost (for stocks) is below established thresholds. The process also includes the monitoring of other impairment indicators such as ratings, ratings downgrades and payment defaults.

The composition of the investment portfolio at December 31 was:

(in millions)	2011	2010
Bonds	$ 22,381	$ 22,911
Preferred stocks	93	156
Common stocks	8,199	8,463
Mortgage loans on real estate	473	17
Real estate	333	322
Cash and cash equivalents	(459)	(439)
Short-term investments	104	54
Other invested assets	3,830	3,318
Total	$ 34,954	$ 34,802

Total invested assets were flat year-over-year increasing only $152 million. Explanations for the more significant items follow.

Bonds

The Group's bond portfolio consists of public and privately placed corporate bonds, municipal bonds, asset-backed securites ("ABS"), U.S. government bonds, mortgage-backed securities ("MBS") and foreign government bonds.

At December 31, 2011, 91.2% of the consolidated bond portfolio was rated investment grade, which is defined as having a NAIC Securities Valuation Office rating of 1 or 2, a Moody's rating of Aaa, Aa, A or Baa, a rating of AAA, AA, A or BBB from S&P, Fitch, Dominion, or Realpoint, a rating of aaa, aa, a or bbb from A.M. Best, or a comparable internal rating if an externally provided rating is not available. The investment grade percentage for each individual bond category ranged from 84.3% to 100%. The most significant change in the bond portfolio mix from the prior year occurred in the privately placed securities portfolio which increased $4.6 billion. There was no significant change in the bond portfolio quality distribution from the prior year.

Bonds with an NAIC rating 1 or 2, including loan backed and structured securities, are carried at amortized cost. Bonds with an NAIC rating 3 through 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 $23.1 billion and $23.3 billion at December 31, 2011 and 2010, respectively. At December 31, 2011, unrealized net capital gains on the bond portfolio, which are measured as the difference between statement value and fair value, were $768 million compared to $382 million as of December 31, 2010.

Public corporate bonds totaled $9.4 billion at December 31, 2011 compared to $4.8 billion at December 31, 2010. As of December 31, 2011, the portfolio also contained $1.9 billion of privately placed corporate obligations, compared with $1.5 billion at December 31, 2010. Privately placed securities primarily consist of corporate issued senior debt securities that are directly negotiated with the borrower or are in unregistered form. Privately placed corporate securities are rated by the National Association of Insurance Commissioners ("NAIC") Securities Valuation Office based on information provided to them.

Municipal bonds including tax-exempt and taxable securities totaled $7 billion, or 31% of the bond portfolio at December 31, 2011 compared to $8.5 billion at December 31, 2010. The municipal bond portfolio at December 31, 2011 consisted of 2,220 issues from 1,048 issuers. The largest exposure to a single issuer was 1% of the municipal bond portfolio. Corporate entities were the ultimate obligors of 4% of the municipal bond portfolio.

ABS totaled $2.6 billion at December 31, 2011 compared to $2.2 billion at December 31, 2010. Credit risk is managed by monitoring the performance of the underlying collateral. Many of the securities in the ABS portfolio have credit enhancement with features such as overcollateralization, subordinated structures, reserve funds, guarantees and/or insurance.

MBS totaled $1.3 billion at December 31, 2011 compared to $2.6 billion at December 31, 2010. The MBS portfolio is subject to interest rate risk, but unlike other fixed income securities, is additionally subject to significant prepayment risk from the underlying mortgages.

The Group identified it had exposure to subprime residential mortgage related risk in the form of asset-backed residential mortgage-backed securities ("ABS RMBS"), as well as a limited partnership investment. 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 borrowers' credit profile. At December 31, 2011, the ABS RMBS portfolio had net unrealized losses of $37 million, comprised of $39 million in gross unrealized losses and $2 million in gross unrealized gains. At December 31, 2010, the ABS RMBS portfolio had net unrealized losses of $34 million, comprised of $35 million in gross unrealized losses and $1 million in gross unrealized gains. The Group believes the unrealized losses on these securities, including those over 24 months, result from the current risk premium on these securities, which should continue to reverse over the securities' remaining lives, as demonstrated by improved valuations in 2010. The Group expects to receive its estimated share of contractual principal and interest collections used to determine the securities' recovery value.

At December 31, 2011, 91.2% of the Group's bond portfolio was rated investment grade, which is defined as having a NAIC Securities Valuation Office rating of 1 or 2, a Moody's rating of Aaa, Aa, A or Baa, a rating of AAA, AA, A or BBB from S&P, Fitch, Dominion, or Realpoint, a rating of aaa, aa, a or bbb from A.M. Best, or a comparable internal rating if an externally provided rating is not available.

Bonds with an NAIC rating 1 or 2, including loan backed and structured securities, are carried at amortized cost. Bonds with an NAIC rating 3 through 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 $23.1 billion and $23.3 billion at December 31, 2011 and 2010, respectively. At December 31, 2011, unrealized net capital gains on the bond portfolio, which are measured as the difference between statement value and fair value, were $768 million compared to $382 million as of December 31, 2010.

Equity securities

Equity securities include common and non-redeemable preferred stocks, and investments in affiliates. The $328 million decrease in common stocks was due to managements' decision to reduce exposure in the equity markets.

Other invested assets

Other invested assets increased $512 million due to additional investments in hedge funds during 2011. Additions to two joint venture investments totaled $300 million. Receivable for securities increased $122 million due to a high volume of sale trades in December, with the settlements occurring in the first week of January.

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)	2011	2010
Balance at January 1	$ 14,785	$ 14,503
Current year	18,657	17,410
Prior years	(296)	(95)
Total incurred	18,361	17,315
Paid related to:		
Current year	12,447	11,168
Prior years	5,610	5,865
Total paid	18,057	17,033
Balance at December 31	$ 15,089	$ 14,785

Incurred losses and loss adjustment expenses attributable to insured events of prior years were $(296) million and $(95) million as a result of the reestimation of unpaid losses and loss adjustment expenses at the years ending December 31, 2011 and 2010, respectively. During 2011, favorable development in incurred losses and loss adjustment expense related to prior year was primarily due to severity development that was better than expected and catastrophes. During 2010, favorable development in incurred losses and loss adjustment expense related to prior years was primarily due to favorable prior year catastrophes and severity development that was better than expected, partially offset by litigation settlements. These changes were generally the result of ongoing analyses of recent loss development trends. Initial estimates were revised as additional information regarding claims became known.

Capital and surplus

The following table summarizes the Group's capital position at December 31:

(in millions)	2011	2010
Common capital stock	$ 4	$ 4
Gross paid in and contributed surplus	4,460	4,238
Unassigned funds (surplus)	10,280	10,945
Aggregate write-ins	398	209
Total surplus as regards policyholders	$ 15,142	$ 15,396

Total surplus as regards policyholders decreased 1.6%, or $254 million, and was mainly comprised of the following items:

- $838 million in dividends paid to Allstate Holdings
- $806 million decrease from the sponsorship change in pension plan
- $784 million increase in additional minimum pension liability
- $410 million increase in deferred income tax
- $239 million in net income
- $228 million increase in non-admitted assets
- $222 million in capital contributions
- $191 million increase in incremental deferred tax asset

RESULTS OF OPERATIONS

(in millions)	2011	2010
Premiums earned	$ 23,410	$ 23,622
Losses incurred	15,277	14,532
Loss expenses incurred	3,084	2,783
Other underwriting expenses incurred	6,042	6,016
Total underwriting deductions	24,403	23,331
Net underwriting gain(loss)	(993)	291
Net investment income earned	1,179	1,091
Net realized capital gains(losses)	(96)	(190)
Net investment gain(loss)	1,083	901
Total other income	170	185
Net income, after dividends to policyholders but before federal and foreign income taxes	260	1,377
Federal and foreign income taxes incurred	21	348
Net income	$ 239	$ 1,029

Net underwriting gain

The $1.3 billion decrease in underwriting gain was primarily due to an increase in homeowners and other personal lines catastrophe losses and a decrease in standard auto underwriting income.

Net realized capital gains(losses)

Net investment income earned was relatively flat year-over-year and, net realized capital losses decreased $94 million to $(96) million in 2011. This decrease was primarily due to the $88.6 million reduction in bond write-downs.

CASH FLOW AND LIQUIDITY

The following table summarizes cash flow.

(in millions)	2011	2010
Net cash from operations	$ 420	$ 861
Net cash from investments	(82)	121
Net cash from financing and miscellaneous sources	(308)	(1,162)
Net change in cash, cash equivalents and short-term investments	$ 30	$ (180)

The Group's operations typically generate substantial positive cash flows from operations as most premiums are received in advance of the time claim payments are made. Cash provided from investments decreased in 2011 as a result of increased purchases during the year. Negative cash flows from financing decreased mainly due to reduced dividends paid to the stockholder in 2011, offset by $222 million in capital contributions received.

Financial strength ratings and outlook

Allstate's financial strength ratings and outlook were A+ (stable), Aa3 (negative) and AA- (negative) and by A.M. Best, Moody's and Standard & Poor's, respectively, as of January 26, 2012.

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 asset and credit risks, but places more emphasis on underwriting factors for reserving and pricing. At December 31, 2011, 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 to assist state regulators in monitoring the financial condition of insurance companies and identifying companies that require special attention or action. 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 thirteen ratios. At December 31, 2011, no insurer comprising the Group had more than two ratio results outside the usual range.