



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, 2013**

The Allstate Life Insurance Group ("Company") consists of Allstate Life Insurance Company ("ALIC"), Allstate Life Insurance Company of New York, Lincoln Benefit Life Company ("LBL"), Charter National Life Insurance Company, Intramerica Life Insurance Company, Allstate Assurance Company 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.

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 and voluntary accident and health insurance products to customers. Its principal products are interest-sensitive, traditional and variable life insurance. Products are sold to individuals through Allstate exclusive agencies and exclusive financial specialists, and workplace enrolling independent agents in New York. The Company's strategy is focused on expanding Allstate customer relationships, growing the number of products delivered to customers through Allstate exclusive agencies, improving returns on our in-force annuity products, and emphasizing capital efficiency and shareholder returns.

On July 17, 2013, the Company entered into a definitive agreement with Resolution Life Holdings, Inc. to sell LBL, LBL's life insurance business generated through independent master brokerage agencies, and all of LBL's deferred fixed annuity and long-term care insurance business for \$600 million subject to certain adjustments as of the closing date. Prior to the closing of the sale, LBL business written through independent master brokerage agencies, totaling approximately \$12 billion of total policy reserves, and ceded to the Company will be recaptured. An estimated \$3 billion of LBL's total policy reserves will continue to be reinsured by the Company. An after-tax gain to the Company on this transaction is estimated to be \$350 million to \$400 million. Additionally, portions of existing non-affiliate reinsurance agreements associated with business ceded from LBL to the Company will be novated effective on the closing date. As of December, 2013, the reinsurance recoverable associated with the novated portions of these reinsurance agreements is expected to approximate \$1.12 billion. On March 25, 2014 the Nebraska Director of Insurance executed a Certificate of Adoption certifying the adoption of the final order of the Department of Insurance approving the sale of LBL. The closing of the sale is scheduled for April 1, 2014.

## **FINANCIAL POSITION**

### **Cash and invested assets**

The return on the investment portfolio is an important component of the Company's financial results. The Company's investment strategy focuses on the total return of assets needed to support the underlying liabilities, asset-liability management and achieving an appropriate return on capital.

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. Within the ranges set by the strategic asset allocation, tactical investment decisions are made in consideration of prevailing market conditions. The Company manages risks associated with interest rates, credit spreads, equity markets, real estate and currency exchange rates. The Company's continuing focus is to manage risks and returns and to position our portfolio to take advantage of market opportunities while attempting to mitigate adverse effects.

The Company continues to focus on shifting the portfolio mix to have less reliance on investments whose returns come primarily from interest payments to investments in which the Company has ownership interests and a greater proportion of return is derived from idiosyncratic operating or market performance including equities and real estate and investing to the specific needs and characteristics of the business. Invested assets and income are expected to decline in line with reductions in contractholder funds.

The composition of the investment portfolio at December 31 was:

(in millions)	2013	2012
Bonds	\$ 37,197	\$ 40,841
Preferred stocks	27	45
Common stocks	649	346
Mortgage loans on real estate	5,405	5,770
Property held for the production of income	28	28
Cash and cash equivalents	610	953
Short-term investments	66	247
Contract loans	832	836
Other invested assets	2,892	2,761
Other	246	147
Total	\$ 47,952	\$ 51,974

Total invested assets decreased \$4.02 billion, or 8%, at December 31, 2013 and was primarily due to net withdrawals on deposit-type contracts and negative cash from operations. Explanation for the most significant items follow.

#### **Bonds**

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

At December 31, 2013, 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; an A.M. Best rating of aaa, aa, a, or bbb; a Moody's rating of Aaa, Aa, A, or Baa, a S&P, Fitch, Dominion, Kroll or Realpoint rating of AAA, AA, A or BBB; or a comparable internal rating if an externally provided rating is not available. The investment grade percentage for each individual bond category ranged from 87% to 100%. The most significant decreases in the bond portfolio mix from the prior year occurred in the U.S. government bonds, ABS, MBS and the privately placed securities portfolio which decreased \$1.59 billion, \$1.10 billion, \$1.06 billion and \$0.82 billion, respectively. The overall decrease in the bond portfolio mix was partially offset by a \$1.04 billion increase in the publicly traded corporate bonds portfolio. 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 loan-backed and other structured securities, are reported at amortized cost using the effective yield method. Bonds with an NAIC designation of 6 are reported at the lower of amortized cost or fair value, with the difference reflected in unassigned surplus. The fair value of bonds was \$38.70 billion and \$44.51 billion at December 31, 2013 and 2012, respectively. Unrealized net capital gains on the bond portfolio, which are calculated as the difference between statement value and fair value, were \$1.50 billion and \$3.67 billion as of December 31, 2013 and 2012, respectively.

Corporate bonds totaled \$26.02 billion and \$25.79 billion at December 31, 2013 and 2012, respectively. As of December 31, 2013, the portfolio also contained \$7.43 billion of privately placed corporate securities compared with \$8.25 billion at December 31, 2012. Privately placed corporate obligations contain structural security features such as financial covenant and call protections that provide investors greater protection against credit deterioration, reinvestment risk or fluctuations in interest rates than those typically found in publicly registered debt securities. At December 31, 2013, 87% of the privately placed securities were rated investment grade.

Municipal bonds, including tax-exempt and taxable securities, totaled \$3.63 billion at December 31, 2013 compared to \$3.72 billion at December 31, 2012. The municipal bond portfolio includes general obligations of state and local issuers and revenue bonds (including pre-refunded bonds, which are bonds for which an irrevocable trust has been established to fund the remaining payments of principal and interest). At December 31, 2013, 99% of the municipal bonds were rated investment grade.

The bond portfolio also contained \$3.55 billion and \$4.66 billion of ABS at December 31, 2013 and 2012, respectively. The ABS portfolio includes collateralized debt obligations and Consumer and other ABS. 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. At December 31, 2013, 93% of the ABS securities

were rated investment grade.

At December 31, 2013 and 2012, \$2.09 billion and \$3.15 billion, respectively, of the bond portfolio were invested in MBS, which consisted of residential MBS ("RMBS") and commercial MBS ("CMBS"). The RMBS portfolio is subject to interest risk, but unlike other fixed income securities, is additionally subject to significant prepayment risk from the underlying residential mortgage loans. The CMBS portfolio is subject to credit risk and has a sequential paydown structure. At December 31, 2013, 88% of the MBS portfolio were rated investment grade.

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

Mortgage loans on real estate decreased \$365 million to \$5.41 billion at December 31, 2013. Mortgage loans are secured 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 the Company will not collect the contractual principal and interest. The Company recorded \$16 million and \$8 million of realized capital losses related to other-than-temporary impairments on mortgage loans for the year ended December 31, 2013 and 2012, respectively. For the years ended December 31, 2013 and 2012, the Company did not report valuation allowances on mortgage loans.

#### **Other invested assets**

Other invested assets increased \$131 million to \$2.89 billion at December 31, 2013 mostly attributed to limited partnerships. The limited partnership portfolio consists of investments in private equity/debt funds, real estate funds, tax credit funds and other funds and is well diversified across a number of characteristics including fund managers, vintage years, strategies, geography (including international), and company/property types.

#### **Common stocks**

Common stocks increased \$303 million to \$649 million at December 31, 2013 mostly due to the current investment strategy.

#### **From Separate Accounts**

Separate Accounts balances increased \$151 million, or 2%, to \$7.30 billion at December 31, 2013 mainly due to improved market performance that exceeded surrenders and benefits.

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.

Separate Accounts held by the Company are for variable annuity contracts, variable life policies and indexed variable annuity contracts. The assets and liabilities of variable annuity contracts and variable life policies are recorded as assets and liabilities of the Separate Accounts and are legally insulated from the General Account. The legal insulation of the Separate Accounts assets prevents such assets from being generally available to satisfy claims resulting from the General Account. Separate Accounts which contain variable annuity and variable life business are unit investment trusts and registered with the Securities and Exchange Commission ("SEC"). As of December 31, 2013 and 2012, all assets of the Separate Accounts that support the variable annuity and variable life business were legally insulated. The assets and liabilities of indexed variable annuity contracts are also recorded as assets and liabilities of the Separate Accounts, however, they are not legally insulated from the General Account. The indexed variable annuity product is non-unitized and is registered with the SEC.

Variable annuity and variable life business allow the contractholder to accumulate funds within a variety of portfolios, at rates which depend upon the return achieved from the types of investments chosen. The net investment experience of the Separate Accounts is credited directly to the contractholder and can be favorable or unfavorable. The assets of each portfolio are held separately from the other portfolios and each has distinct investment objectives and policies. 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 Account's funds may not meet their stated investment objectives.

Indexed variable annuity products provide the opportunity for the contractholder to invest for a specified length of 5, 7, or 10 years in one or more investment options linked to the S&P 500 and subject to a maximum and minimum

investment performance which may be negative.

### **Aggregate reserve for life contracts**

(in millions)	2013	2012
Fixed annuities	\$ 11,636	\$ 13,138
Interest sensitive life	10,572	10,322
Structured settlements	7,097	7,109
MVAA	3,735	4,352
Indexed annuities	3,319	3,345
Traditional life	2,059	1,894
Annuity buyouts	909	962
Single premium immediate annuities	531	551
Payout annuities	625	591
Other	364	286
Total	\$ 40,847	\$ 42,550

Aggregate reserves for life contracts decreased \$1.70 billion to \$40.85 billion as of December 31, 2013 and were primarily driven by decreases in fixed annuities reserves (\$1.50 billion) and MVAA reserves (\$0.62 billion). These decreases were mainly due to the payment of death benefits and surrenders on fixed annuities.

### **Asset valuation reserve**

Asset valuation reserve ("AVR") increased \$168 million to \$624 million as of December 31, 2013. The increase was mostly attributed to bonds (\$89 million) within the default component, and common stocks (\$43 million) and other invested assets (\$27 million) within the equity component. The overall increase in AVR was primarily driven by the significant increase in the current year unrealized capital gains in the investment portfolio.

### **Payable for securities lending**

Payable for securities lending decreased \$221 million to \$322 million as of December 31, 2013 due to decreased securities lending activities in the current year.

### **Capital and surplus**

Capital and surplus decreased \$520 million to \$2.97 billion as of December 31, 2013. The decrease was mainly due to the return of capital to its parent (\$500 million), the partial repayment (\$200 million) of the surplus note issued to its parent, the increase in AVR (\$168 million), the change in surplus as a result of reinsurance (\$134 million), the increase in nonadmitted assets (\$85 million), and the decrease in net deferred income tax (\$21 million). The overall decrease was partially offset by current year net income (\$447 million) and the increase in net unrealized capital gains (\$140 million).

## RESULTS OF OPERATIONS

(in millions)	2013	2012
Premiums and annuity considerations	\$ 2,652	\$ 2,491
Net investment income including IMR amortization	2,513	2,526
Commissions and expense allowances	256	308
Reserve adjustments on reinsurance ceded	(1,099)	(1,081)
Income from fees	59	61
Other income	3	8
Total revenue	4,384	4,313
Provision for benefits	4,177	4,169
Commissions and general insurance expenses	765	771
Insurance taxes, licenses and fees	65	53
Net transfers to or (from) Separate Accounts	(1,052)	(1,057)
Total expense	3,955	3,936
Net gain from operations before dividends to policyholders and federal income taxes	429	377
Federal and foreign income taxes incurred	(56)	(108)
Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains (losses)	485	485
Realized gains (losses), net of IMR and federal income taxes	(38)	(104)
Net income	\$ 447	\$ 381

### **Net income**

The Company reported net income of \$447 million for 2013, representing an increase of \$66 million from the prior year. Net gain from operations after dividends to policyholders and federal income taxes and before realized capital losses was comparable to 2012 with premiums increasing \$161 million, partially offset by a \$52 million decrease in commissions and expense allowances and a \$52 million decrease in federal income tax benefit.

### **Premiums and annuity considerations**

Premiums and annuity considerations increased \$161 million, or 6%, due in large part to the increase in indexed annuities of \$150 million.

### **Commissions and expense allowances**

Commission and expense allowances decreased \$52 million, or 17%, primarily due to a refinement of the assumptions used to amortize the deferred gain on the sale of its variable annuity business in 2006.

### **Provision for benefits**

A slight increase (\$8 million) in the provision for benefits was largely attributed to a \$791 million unfavorable change in aggregate reserves for life and accident and health contracts, partially offset by a \$692 million decrease in surrenders and a \$98 million decrease in annuity benefits. The increase in reserves was primarily attributed to fixed annuities (\$528 million) mostly driven by lower surrenders. Also contributing to the increase in reserves was indexed annuities (\$176 million) primarily driven by an increase in premiums. The decrease in surrenders was mostly related to fixed annuities (\$586 million) and market value adjusted annuities (\$137 million).

## CASH FLOW AND LIQUIDITY

The following table summarizes cash flow.

(in millions)	2013	2012
Net cash from operations	\$ (1,196)	\$ (1,904)
Net cash from investments	3,658	2,649
Net cash from financing and miscellaneous sources	(2,986)	(260)
Net change in cash, cash equivalents and short-term investments	\$ (524)	\$ 485

The principal sources of cash flows from operations were premiums, investment income and net transfers from Separate Accounts. 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 78% 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, mainly due to scheduled distributions of maturing funding agreements, return of capital of \$500 million, partial surplus note repayment of \$200 million, and other cash applied of \$161 million mostly from a decrease in securities lending collateral.

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, 2013, excluding Separate Accounts, consisted of \$31.35 billion, or 70%, of total reserves in force. Of the total annuity reserves, \$15.49 billion, or 42%, 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 were A+ (superior) with a stable outlook, A+ (good) with a stable outlook and A1 (good) with a stable outlook by A.M. Best, Standard & Poor's and Moody's, respectively, at January 31, 2014.

### Risk based capital

The NAIC has a uniform capital adequacy standard, referred to as the risk-based capital ("RBC"), that serves as one of the solvency monitoring regulatory tools to measure and assess the amount of capital that is appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. The standard utilizes a formula to calculate a company's minimum capital requirement ("company action level RBC") based on the insurance, business, asset and interest rate risk associated with its business. There is no regulatory action required if a company maintains an actual capital level greater than the company action level RBC. A RBC model law does, however, mandate four levels of regulatory action based on a company's degree of capital impairment. At December 31, 2013, each of the insurers comprising the Group had actual capital that was significantly above the company action level RBC.

### 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 that require special attention or action. IRIS ratios are not applicable to ALIC Re, a special purpose financial captive insurance company domiciled in South Carolina. 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 of the twelve ratios. At December 31, 2013, 3 of the 6 applicable insurers comprising the Company had at least one ratio that was out of the usual range.

## OTHER

The Company's reinsurance ceded on life insurance in force decreased \$13.56 billion to \$195.41 billion at December 31, 2013 compared to \$208.97 billion at December 31, 2012. The Company enters into reinsurance

agreements with unaffiliated reinsurers to limit risk of mortality and morbidity losses, while retaining primary liability as a direct insurer for all risks ceded to reinsurers.

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

As of December 31, 2013 and 2012, 36% and 39%, 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 to non-affiliates.

The credit worthiness of external reinsurers is continuously monitored. As of December 31, 2013, 94% of ceded premiums under uncollateralized external reinsurance treaties were ceded to companies that currently have an A.M. Best financial strength rating of A- or better.