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Allstate Insurance Group
Combined Management Discussion and Analysis
For the Year Ended December 31, 2016

OVERVIEW

The Allstate Insurance Group (referred to as the "Group") consists of Allstate County Mutual Insurance Company, Allstate Fire and Casualty Insurance Company, Allstate Indemnity Company, Allstate Insurance Company ("AIC"), Allstate Northbrook Indemnity Company, Allstate North American Insurance Company, Allstate Property and Casualty Insurance Company, Allstate Texas Lloyd's, Allstate Vehicle and Property Insurance Company, Encompass Home and Auto Insurance Company, Encompass Indemnity Company, Encompass Independent Insurance Company, Encompass Insurance Company, Encompass Insurance Company of America, Encompass Insurance Company of Massachusetts, Encompass Property and Casualty Company, Esurance Insurance Company and Esurance Property and Casualty 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 combined affiliated property-liability insurers listed above, the Group has several uncombined 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 uncombined 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. North Light Specialty Insurance Company ("NLSIC") writes excess and surplus lines through surplus lines brokers, with the concentration on homeowners. Separate MD&As were filed for Allstate Life and certain of its subsidiaries, ANJ, CKIC and NLSIC. Allstate Insurance Company of Canada is an affiliated foreign insurer, which has three subsidiary insurance companies and has regulatory filings with the Office of the Superintendent of Financial Institutions.

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. 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.

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 where the Group accepts underwriting risk: Allstate®, Esurance® and Encompass®. 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 property-liability 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 Group's products are marketed under the Allstate, Esurance and Encompass brand names. The Allstate brand serves customers who prefer local personalized advice and service and are brand-sensitive. The Esurance brand serves self-directed, brand-sensitive customers, while the Encompass brand serves customers who prefer personal advice and assistance from an independent adviser and are brand-neutral.

The Allstate brand utilizes marketing delivered to target customers to promote the Group's strategic priorities, with messaging that communicates the value of the Group's "Good Hands®", the importance of having proper coverage by highlighting our comprehensive product and coverage options, and the ease of doing business with Allstate and Allstate agencies.

The Allstate brand differentiates itself from competitors by offering a comprehensive range of innovative product options and features through a network of agencies that provide local advice and service. Allstate brand offers Allstate Your Choice Auto® with product features and options such as Accident Forgiveness, Deductible Rewards®, Safe Driving Bonus® and New Car Replacement. The Allstate House and Home® product includes features such as Claim RateGuard®, Claim-Free Bonus, flexibility in options and coverages, including graduated roof coverage and pricing based on roof type and age for damage related to wind and hail events. In addition, the Group offers a Claim Satisfaction Guarantee℠ that promises a return of premium to Allstate brand auto insurance customers dissatisfied with their claims experience. The Group's Drivewise® program, available in 49 states and the District of Columbia as of December 31, 2016, uses a mobile application or an in-car device to capture driving behaviors and reward customers for driving safely. The Drivewise mobile application also provides customers with information and tools to encourage safer driving and incentivize through driving challenges. In 2015, Drivewise began offering Allstate Rewards®, a program that provides reward points for safe driving. Milewise®, Allstate's usage based insurance product, was launched in 2016 and is currently available to customers as a limited market test. Milewise gives customers flexibility to customize their insurance and pay based on the number of miles they drive. The Group will continue to focus on developing and introducing products and services that benefit today's customers and further differentiate the Group and enhance the customer experience.

The Group plans to deepen customer relationships through value-added customer interactions and expanding its presence in households with multiple products by providing financial protection for customer needs. When an Allstate product is not available, the Group may make available non-proprietary products for customers through brokering arrangements. Allstate agencies sell non-proprietary property insurance products, primarily related to property business in hurricane exposed areas and commercial insurance. These non-proprietary products are offered to the Group's customers who prefer to use a single agent for all of their insurance needs.

The Group continues to enhance technology to improve customer service, facilitate the introduction of new products and services, improve the handling of claims and reduce infrastructure costs related to supporting the Group's agency force. 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.
Allstate brand auto and homeowners insurance products are sold primarily through Allstate exclusive agencies and serve customers who prefer local personalized advice and service and are brand-sensitive. The Allstate brand also sells specialty auto products including motorcycle, trailer, motor home and off-road vehicle insurance policies.

Other personal lines sold under the Allstate brand include renter, condominium, landlord, boat, umbrella and manufactured home insurance policies. Commercial lines primarily include auto insurance products for small business owners.

The Group's strategy for the Esurance brand focuses on self-directed customers. To best serve these customers, Esurance develops its technology, website and mobile capabilities to continuously improve its hassle-free purchase and claims experience and offer innovative product options and features. Esurance continues to develop additional products to complement its auto line of business and provide a more comprehensive solution to its customers. Esurance also continues to invest in geographic expansion of its products. Esurance expanded its homeowners products in 2016 from 25 to 31 states and renters from 20 to 21 states. Esurance continues to focus on increasing its preferred driver mix, while raising marketing effectiveness to support growth and profitability. Esurance's DriveSense® program, available in 32 states as of December 31, 2016, enables participating customers to be eligible for discounts based on driving performance as measured by a device installed in the vehicle or a mobile application. Esurance Pay Per Mile® usage-based insurance product was launched in 2015 and gives customers flexibility to customize their insurance and pay based on the number of miles they drive.

The Group's strategy for the Encompass brand centers around offering broad coverage options specifically focused on the customers who prefer an independent agency while simplifying the insurance experience by packaging products into a single annual household ("package") policy with one premium, one bill, one policy deductible, one renewal date and one advisor - an independent insurance agent. Package policies represent over 85% of premiums written where they are offered, with concentrations in suburban and urban areas throughout the country. Package policies currently are not offered in Massachusetts, North Carolina and Texas. In pursuit of this strategy and to achieve its financial objectives, Encompass is partnering with dedicated independent agency professionals who understand the needs of our coverage conscious customers and the value of the Encompass products. Agency segmentation and strategic deployment are a continued focus, as are improved sales leader effectiveness and accountability. Encompass is focused on improving returns while building a foundation for future growth. The Group seeks to achieve these goals in 2017 by continuing to implement profit improvement actions in states with inadequate returns, continuing to contemporize product offerings, and maintaining focus on claims operational excellence, while accelerating growth in markets achieving target returns.

The Group's pricing and underwriting strategies and decisions for all of its brands are primarily designed to achieve appropriate returns along with enhancing its competitive position. Sophisticated pricing methodology allows the Group to attract and retain customers in multiple risk segments. A combination of underwriting information, pricing and discounts are also used to achieve a more competitive position. The Group's pricing strategy involves local marketplace pricing and underwriting decisions that are based on these risk evaluation factors and an evaluation of competitors to the extent permissible by applicable law.

Pricing of property products is typically intended to establish risk adjusted 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 recognized 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 product pricing. The Group pursues rate increases where indicated, taking into consideration potential customer disruption, the impact on its ability to market auto and homeowners lines, regulatory limitations, competitive position and profitability, using a methodology that appropriately addresses the changing costs of losses from catastrophes such as severe weather and the net cost of reinsurance.

CATASTROPHE MANAGEMENT

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 a winter weather 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 and freezes, 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 reliably predicted.

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.

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; 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.

Property catastrophe exposure management includes purchasing reinsurance to provide coverage for known exposure to hurricanes, earthquakes, wildfires, fires following earthquakes and other catastrophes. The Group is also working to promote measures to prevent and mitigate losses and make homes and communities more resilient, including enactment of stronger building codes and effective enforcement of those codes, adoption of sensible land use policies, and development of effective and affordable methods of improving the resilience of existing structures.

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

- Continuing to limit or not offer new homeowners, manufactured home and landlord package policy business in certain coastal geographies.
- Increased capacity in the brokerage platform for customers not offered an Allstate policy.
- In certain states, the Group has been ceding wind exposure related to insured property located in wind pool eligible areas.
- In 2016, we began to write a limited number of homeowners policies in select areas of California. Meanwhile, the Group will continue to renew current policyholders and allow replacement policies for existing customers who buy a new home, or change their residence to rental property. For landlord package policies the Group allows replacement policies on an exception basis, and offers a small number of new landlord package policies in order to accommodate current personal umbrella policy customers.
- Tropical cyclone deductibles are generally higher than all peril deductibles and are in place for a large portion of coastal insured properties.
- The Group has additional catastrophe exposure, beyond the property lines, for auto customers who have purchased physical damage coverage. Auto physical damage coverage generally includes coverage for flood-related loss. The Group manages this additional exposure through inclusion of auto losses in our nationwide reinsurance program, including Florida personal lines automobile business, as of June 1, 2016. New Jersey is excluded from the nationwide reinsurance program as auto losses are included in our New Jersey reinsurance program.
- Designed the Group's homeowners new business offering, Allstate House and Home, that provides options of coverage for roof damage including graduated coverage and pricing based on roof type and age. Allstate House and Home is currently available in 40 states. The House and Home product is available in 75% of the states where the Group's catastrophe losses occurred in 2016.

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 it achieves adequate returns and do not materially increase its hurricane risk.

DODD-FRANK

The Secretary of the Treasury (operating through Federal Insurance Office ("FIO")) and the Office of the U.S. Trade Representative ("USTR") are jointly authorized, pursuant to Dodd-Frank, to negotiate a Covered Agreement with one or more foreign governments, authorities, or regulatory entities. A Covered Agreement is a written bilateral or multilateral agreement that "relates to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation." A Covered Agreement becomes effective 90 days after the Secretary of the Treasury and USTR jointly submit a final agreement to the House Financial Services, House Ways and Means, Senate Banking, and Senate Finance committees. The House and Senate committees are not required to vote on the Covered Agreement for it to become effective. As provided in Dodd-Frank, a Covered Agreement cannot preempt (i.e., displace) state insurance measures that govern an insurer's rates, premiums, underwriting or sales practices; any state insurance coverage requirements; the application of antitrust laws of any state to the business of insurance; or any state insurance measure governing insurer capital or solvency, except where a state insurance measure results in less favorable treatment of a non-U.S. insurer than a U.S. insurer.

In November 2015, pursuant to Dodd-Frank, Treasury and USTR notified Congress that they were formally initiating negotiations on a Covered Agreement with the European Union ("EU") (the "Covered Agreement") addressing: permanent equivalence treatment of the U.S. regulatory system by the EU; confidential sharing of information across jurisdictions; and uniform treatment of EU-based reinsurers operating in the U.S., including with respect to reinsurance collateral. On January 13, 2017, the Secretary of the Treasury and USTR jointly submitted a Covered Agreement (unsigned) consistent with their November 2015 notification to Congress. Once effective, the Covered Agreement is designed to secure equivalence treatment of the U.S. regulatory system by the EU, addresses the confidential sharing of information by regulators across jurisdictions, and eliminate reinsurance collateral requirements for EU-based foreign reinsurers in all States that meet certain conditions. In accordance with authorities provided in Dodd-Frank, the Covered Agreement may preempt (i.e., displace) state laws after 60 months from its effective date if then existing State insurance measures affected by the Covered Agreement result in less favorable treatment of an EU insurer or reinsurer subject to the Covered Agreement than a U.S. insurer domiciled, licensed, or otherwise admitted in a U.S. State. In addition, the Covered Agreement endorses a group capital standard which exists in the EU and not in the U.S. as the designated capital and solvency. Framework for these determinations is in the U.S. risk-based capital.

Prior to the Secretary of the Treasury and the USTR submitting the Covered Agreement to Congress, the NAIC had amended its Credit for Reinsurance Model Law and Regulation in 2011 ("Revised Reinsurance Model Law"), and statutory enactments implementing the amendments have been passed in 35 states. The amendments establish a new category of "certified reinsurers," allowing domestic insurers to receive statutory capital credit for reinsurance ceded to certified reinsurers absent the reinsurers fully collateralizing their assumed reinsurance obligations. Under the NAIC's regulatory scheme preceding the Revised Reinsurance Model Law, which remains in effect in Illinois, domestic ceding companies are not allowed to take statutory capital credit for reserves ceded to unauthorized reinsurers unless the insurer withholds funds due to the reinsurer in an amount equal to the reserves, obtains a letter of credit on behalf of the unauthorized reinsurer equal to the amount of the reserves, or is the beneficiary of a credit for reinsurance trust with assets equal to the amount of the reserves.

The terms of the Covered Agreement provide states with 60 months from the effective date of the Covered Agreement to modify their state-based regulatory requirements to comply with the terms of the Covered Agreement. In accordance with the terms of the Covered Agreement, and consistent with the authorities set forth in Dodd-Frank, after 42 months from the effective date of the Covered Agreement, the U.S. is to begin a process of notifying states of potential preemption for any state insurance measure that is inconsistent with the terms of the Covered Agreement such as those described above. After 60 months from the effective date of the Covered Agreement, the U.S. is to complete any preemption determinations with respect to any U.S. State insurance measures subject to evaluation.

On June 23, 2016, the U.K. held a referendum in which they voted to leave the EU. Following the vote, the U.K. is developing a formal plan for withdrawal under Article 50 of the Lisbon Treaty that is expected to commence as early as March of 2017. If the British Parliament authorizes the initiation of Brexit discussions in March 2017 pursuant to Article 50, withdrawal is expected to be completed during 2019. Article 50 provides only for the negotiation of a withdrawal arrangement but does not address future relationships between the U.K. and EU. Upon exiting the EU, the U.K. insurance market will no longer be in the scope of the Covered Agreement.

FINANCIAL POSITION

Cash and invested assets

The Group's investment strategy emphasizes protection of principal and consistent income generation, within a total return framework. This approach has produced competitive returns over the long term and is designed to ensure financial strength and stability for paying claims, while maximizing economic value and surplus growth. The Group identifies a strategic asset allocation which considers the nature of the liabilities and the risk and return characteristics of the various asset classes in which it invests. This allocation is informed by our long-term and market expectations, as well as other considerations such as risk appetite, portfolio diversification, duration, desired liquidity and capital. Within appropriate ranges relative to strategic allocations, tactical allocations are made in consideration of prevailing and potential future market conditions. We manage risks that involve uncertainty related to interest rates, credit spreads, equity returns and currency exchange rates.

The Group utilizes four high level strategies to manage risks and returns and to position the portfolio to take advantage of market opportunities while attempting to mitigate adverse effects. As strategies and market conditions evolve, the asset allocation may change or assets may move between strategies.

Market-Based Core strategy seeks to deliver predictable earnings aligned to business needs through investments primarily in publicly traded bonds and common stocks. Private fixed income assets, such as commercial mortgages, bank loans and privately placed debt are also included in this category. As of December 31, 2016, 71% of the portfolio follows this strategy with 70% in bonds and commercial mortgage loans and 24% in common stocks.

Market-Based Active strategy seeks to outperform within the public markets through tactical positioning and by taking advantage of short-term opportunities. This strategy may generate results that meaningfully deviate from those achieved by market indices, both favorably and unfavorably. The portfolio primarily includes publicly traded bonds and common stocks. As of December 31, 2016, 20% of the portfolio follows this strategy with 76% in bonds and 14% in common stock.

Performance-Based Long-Term strategy seeks to deliver attractive risk-adjusted returns over a longer horizon. The return is a function of both general market conditions and the performance of the underlying assets or businesses. The portfolio, which primarily includes private equity, real estate, infrastructure, timber and agriculture-related assets, is diversified across a number of characteristics, including managers or partners, vintage years, strategies, geographies (including international) and industry sectors or property types. These investments are generally illiquid in nature, often require specialized expertise, typically involve a third party manager, and may offer the potential to add value through transformation at the company or property level. As of December 31, 2016, 8% of the portfolio follows this strategy with 85% in other invested assets primarily invested in limited partnerships.

Performance-Based Opportunistic strategy seeks to earn attractive returns by making investments that involve asset dislocations or special situations, often in private markets. As of December 31, 2016 less than 1% of the portfolio follows this strategy.

Portfolio composition by investment strategy

The following table presents the investment portfolio by strategy as of December 31, 2016:

($ in millions)	Total	Market-Based Core	Market-Based Active	Performance-Based Long-Term	Performance-Based Opportunistic
Bonds	$ 26,285	$ 19,963	$ 6,239	$ 83	$ -
Preferred stocks	64	39	13	12	-
Common stocks	8,190	7,023	1,127	40	-
Mortgage loans on real estate	280	280	-	-	-
Real estate	346	-	-	346	-
Cash and cash equivalents	(466)	(466)	-	-	-
Short-term investments	1,625	767	857	1	-
Other invested assets	3,650	989	-	2,648	13
Total	$ 39,974	$ 28,595	$ 8,236	$ 3,130	$ 13
% of total		71%	21%	8%	-%

The Group continues to shift the portfolio mix to include more performance-based investments. A greater proportion of the return on these investments is derived from idiosyncratic assets or operating performance. While the Company anticipates higher returns on these investments over time, the investment income can vary significantly between periods.

The Group has a comprehensive portfolio monitoring process to identify and evaluate each security whose carrying value may be other-than-temporarily impaired. 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 amortized cost (for bonds) 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 as of December 31 was:

(in millions)	2016	2015
Bonds	$ 26,285	$ 25,891
Preferred stocks	64	68
Common stocks	8,190	7,443
Mortgage loans on real estate	280	296
Real estate	346	344
Cash and cash equivalents	(466)	50
Short-term investments	1,625	229
Other invested assets	3,650	3,338
Total	$ 39,974	$ 37,659

Total invested assets increased $2.32 billion, or 6%, compared to prior year. Explanations for the more significant items follow.

Bonds

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

As of December 31, 2016, 77.6% of the consolidated bond portfolio was rated investment grade quality, which is defined as having a National Association of Insurance Commissioners ("NAIC") Securities Valuation Office designation 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 Global Ratings ("S&P") a comparable rating from another nationally recognized rating agency, or a comparable internal rating if an externally provided rating is not available. The investment grade percentage for each individual bond category ranged from 51% to 100%. There was no significant change in the bond portfolio quality distribution from the prior year.

Bonds with an NAIC designation 1 or 2, including loan-backed and structured securities, are reported at amortized cost using the effective yield method. Bonds with an NAIC designation of 3 through 6 are reported at the lower of amortized cost or fair value, with the difference reflected in unassigned surplus as unrealized capital loss.

Publicly traded corporate bonds totaled $13.42 billion as of December 31, 2016 compared to $13.78 billion as of December 31, 2015. As of December 31, 2016, the portfolio also contained $6.05 billion of privately placed corporate obligations, compared with $5.61 billion as of December 31, 2015. 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 obligations may contain structural security features such as financial covenants 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. As of December 31, 2016, 51% of the privately placed securities were rated investment grade.

Municipal bonds totaled $3.91 billion as of December 31, 2016 compared to $3.63 billion as of December 31, 2015. The municipal bond portfolio as of December 31, 2016 consisted of 1,611 issues from 640 issuers. The largest exposure to a single issuer was 2% of the municipal bond portfolio. Corporate entities were the ultimate obligors of 1% of the municipal bond portfolio.

U.S. government bonds totaled $1.29 billion as of December 31, 2016 compared to $1.21 billion as of December 31, 2015.

ABS totaled $1.26 billion as of December 31, 2016 compared to $1.19 billion as of December 31, 2015. 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 $322 million as of December 31, 2016 compared to $395 million as of December 31, 2015. The MBS portfolio is subject to interest rate risk, but unlike other fixed income securities, is additionally subject to prepayment risk from the underlying mortgages.

Foreign government bonds totaled $34 million as of December 31, 2016 compared to $79 million as of December 31, 2015.

The fair value of all bonds was $26.45 billion and $26.01 billion as of December 31, 2016 and 2015, respectively. As of December 31, 2016, unrealized net capital gains on the bond portfolio, which are calculated as the difference between statement value and fair value, were $170 million compared to $123 million as of December 31, 2015.

Equity securities

Equity securities include $8.19 billion of common and $64 million of non-redeemable preferred stocks, and investments in affiliates as of December 31, 2016 compared to $7.44 billion of common and $68 million of non-redeemable preferred stocks, and investments in affiliates as of December 31, 2015. The net increase was due to increased investments in equity markets and realization of losses via write-downs, partially offset by realizations of net trading gains.

Cash and cash equivalents

The $516 million decrease in cash and cash equivalents was primarily due to a decrease in cash equivalents as the Company invested in the Allstate Short term pool commencing in the third quarter, 2016 as well as an increase in outstanding claim checks.

Short-term investments

The $1.40 billion increase in short-term investments was due primarily to the investment in the Allstate Short term pool.

Other invested assets

The $312 million increase in other invested assets was driven by the funding of new investments primarily limited partnerships. Limited partnership interests include interests in private equity funds and co-investments, real estate funds and joint ventures, and other funds.

Reserves for losses and loss adjustment expenses

Incurred losses and loss adjustment expenses represent the sum of paid losses and reserve changes in the calendar year. This expense included net losses from catastrophes of $2.50 billion and $1.70 billion in 2016 and 2015, respectively. Activity in the reserve for losses and loss adjustment expenses is summarized as follows:

(in millions)	2016	2015
Balance at January 1	$ 15,505	$ 14,665
Incurred related to		
Current year	20,340	19,097
Prior years	51	139
Total incurred	20,391	19,236
Paid related to:		
Current year	13,214	12,436
Prior years	6,256	5,960
Total paid	19,470	18,396
Balance as of December 31	$ 16,426	$ 15,505

Incurred losses and loss adjustment expenses attributable to insured events of prior years were $51 million and $139 million as a result of the reestimation of unpaid losses and loss adjustment expenses for the years ended December 31, 2016 and 2015, respectively, including net increases in Discontinued Lines and Coverages reserves of $91 million and $56 million, respectively. 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.

Unsecured reinsurance recoverables

The Group has unsecured reinsurance recoverables that exceeded 3% of policyholder surplus as of December 31 as follows:

($ in millions) Reinsurer	NAIC Group Code	FEIN	2016	2015
Michigan Catastrophic Claim Association ("MCCA")	0000	AA-9991159	$ 4,791	$ 4,661
New Jersey Unsatisfied Claim and Judgment Fund ("UCJF")	0000	AA-9991160	$ 495	$ 489

The MCCA is a mandatory insurance coverage and reinsurance indemnification mechanism for personal injury protection losses that provides indemnification for losses over a retention level that increases every other MCCA fiscal year by the lesser of 6% or the increase in the Consumer Price Index. The retention level will be $555 thousand per claim for the fiscal two-years ending June 30, 2019 compared to $545 thousand per claim for the fiscal two-years ending June 30, 2017. The MCCA is obligated to fund the ultimate liability for member companies (companies actively writing motor vehicle coverage in Michigan and those with runoff policies) qualifying claims and claims expenses. The MCCA operates similar to a reinsurance program and is annually funded by participating member companies (companies actively writing motor vehicle coverage in Michigan) through a per vehicle annual assessment. The MCCA has been legally authorized to annually assess participating member companies pursuant to enabling legislation that describes both the annual determination and assessment. This assessment is recorded as a component of the premiums charged to the Company's customers. These assessments paid to the MCCA provide funds for the indemnification for losses described above. The MCCA is required to assess an amount each year sufficient to cover members' actuarially determined present value of expected payments on lifetime claims of all persons expected to be catastrophically injured in that year, its operating expenses, and adjustments for the amount of excesses or deficiencies in prior assessments. The MCCA prepares statutory-basis financial statements in conformity with accounting practices prescribed or permitted by the State of Michigan Department of Insurance and Financial Services ("MI DOI"). The MI DOI has granted the MCCA a statutory permitted practice that expires in 2019 to discount its liabilities for loss and loss adjustment expense. As of June 30, 2016, the date of its most recent annual financial report, the MCCA had cash and invested assets of $18.48 billion and an accumulated deficit of $1.74 billion. The permitted practice reduced the accumulated deficit by $42.27 billion.

The New Jersey Property-Liability Insurance Guaranty Association ("PLIGA"), as the statutory administrator of the UCJF, provides compensation to qualified claimants for personal injury protection, bodily injury, or death caused by private passenger automobiles operated by uninsured or "hit and run" drivers. The UCJF also provides private passenger stranger pedestrian personal injury protection benefits when no other coverage is available. The fund provides reimbursement to insurers for the medical benefits portion of personal injury protection coverage paid in excess of $75 thousand with no limits for policies issued or renewed prior to January 1, 1991 and in excess of $75 thousand and capped at $250 thousand for policies issued or renewed from January 1, 1991 to December 31, 2004. PLIGA annually assesses all admitted property and casualty insurers writing motor vehicle liability insurance in New Jersey for direct PLIGA expenses and UCJF reimbursements and expenses.

Capital and surplus

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

(in millions)	2016	2015
Common capital stock	$ 22	$ 22
Gross paid in and contributed surplus	4,082	4,003
Unassigned funds (surplus)	12,198	11,975
Aggregate write-ins for special surplus funds	40	52
Total surplus as regards policyholders	$ 16,342	$ 16,052

Total surplus as regards policyholders increased $290 million or 2%, and was mainly comprised of the following items:

- $1.39 billion - Net income in 2016 compared to $1.71 billion in 2015
- $603 million - Change in net unrealized capital gains in 2016 compared to $201 million net unrealized capital losses in 2015
- $1.92 billion - Dividends paid to Allstate Holdings in 2016 compared to $2.34 billion in 2015

RESULTS OF OPERATIONS

(in millions)	2016	2015
Premiums earned	$ 28,368	$ 27,445
Losses incurred	17,172	16,319
Loss expenses incurred	3,219	2,918
Other underwriting expenses incurred	7,160	7,075
Total underwriting deductions	27,551	26,312
Net underwriting gain	817	1,133
Net investment income earned	1,152	1,423
Net realized capital gains (losses)	(200)	(229)
Net investment gain	952	1,194
Total other income	112	111
Net income, after dividends to policyholders but before all other federal and foreign income taxes	1,881	2,438
Federal and foreign income taxes incurred	491	725
Net income	$ 1,390	$ 1,713

Net underwriting gain

The $316 million decrease in underwriting gain was mostly due to declines in homeowners resulting from increased catastrophe losses and commercial lines, partially offset by an increase in auto resulting from increased insurance premiums.

Our underwriting results were impacted by our profit improvement actions. We regularly monitor profitability trends and take appropriate pricing actions, underwriting actions, claims process improvements and targeted expense spending reductions to achieve adequate returns.

Given auto loss trends emerging in 2015 and continuing into 2016, we responded with a multi-faceted approach to improve profitability, which has impacted our growth and retention.

- We increased and accelerated rate filings broadly across the country. We continue to aggressively pursue rate increases to respond to higher loss trends, subject to regulatory processes and review.
- We made underwriting guideline adjustments in state specific locations and customer segments experiencing less than acceptable returns which reduced the number of new issued applications and slowed growth. Underwriting guideline adjustments vary by state and include restrictions on business with no prior insurance as well as business with prior accidents and violations. Changes in down payment requirements and coverage plan adjustments have also been implemented. These changes are intended to increase underwriting margin and are continually monitored. In 2016, as targeted underwriting results in these segments were achieved, the guidelines were modified appropriately.

For homeowners, we continue to be disciplined in how we manage margins through underwriting guidelines, risk management policies, property inspections and implement rate and other actions to maintain or improve returns where required. Our growth actions planned include continuing to implement our House & Home product, leveraging agency sales practices focused on multi-line households, increasing availability in coastal markets, improving penetration in underserved markets in the middle of the country and targeted advertising campaigns.

Net investment gains

Net investment gain decreased $242 million, mainly due to the decrease in net investment income earned of $271 million to $1,152 million in 2016 from $1,423 million in 2015, driven primarily by lower dividend income from uncombined subsidiaries.

CASH FLOW AND LIQUIDITY

The following table summarizes cash flow.

(in millions)	2016	2015
Net cash from operations	$ 2,917	$ 2,766
Net cash from investments	(725)	(109)
Net cash from financing and miscellaneous sources	(1,312)	(2,335)
Net change in cash, cash equivalents and short-term investments	$ 880	$ 322

The Group's operations typically generate substantial cash flows from operations as most premiums are received in advance of the time claim payments are made. Net cash from operations increased in 2016 as a result of an increase in premiums collected net of reinsurance and the decrease in federal income taxes, partially offset by an increase in benefits and loss related payments. Net cash from investments decreased in 2016 due to increased purchase and sale activity during the year. Negative net cash flows used in financing decreased mainly due to lower dividends paid in 2016 compared to 2015.

Financial strength ratings and outlook

The Company's most recent financial strength ratings and outlook were A+ (exceptional), Aa3 (excellent) and AA- (excellent) from A.M. Best, Moody's and S&P, respectively; all with a stable outlook.

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, interest rate, market, credit, underwriting and reserving 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. As of December 31, 2016, the total adjusted capital of each insurer comprising the Group 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 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. As of December 31, 2016, no insurer comprising the Group had more than two ratio results outside the usual range.