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**Allstate Life Insurance Group
Combined Management Discussion and Analysis
For the Year Ended December 31, 2017**

The Allstate Life Insurance Group ("Company") consists of Allstate Life Insurance Company ("ALIC"), Allstate Life Insurance Company of New York 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"), an Illinois domiciled insurer. AIC is a wholly-owned subsidiary of Allstate Insurance Holdings, LLC ("AIH"), a Delaware limited liability company. AIH is a wholly-owned subsidiary of The Allstate Corporation ("Corporation").

The Company is licensed to conduct business in all states, the District of Columbia and Puerto Rico. The Company sells traditional and interest-sensitive life insurance products. The Company also sells variable life insurance in New York, while previously selling variable life insurance nationwide through September 2017. The Company distributes its products through Allstate exclusive agencies and exclusive financial specialists. The Company also sells voluntary accident and health insurance through workplace enrolling independent agents in New York. The Company previously offered and continues to have in force fixed annuities such as deferred and immediate annuities. The Company previously offered variable annuities and substantially all of this business is reinsured. Allstate exclusive agencies and exclusive financial specialists also sell non-proprietary retirement and investment products, including mutual funds, fixed and variable annuities, disability insurance and long-term care insurance to provide a broad suite of protection and retirement products.

The Company's strategy is to deepen Allstate customer relationships by fully integrating into the Allstate brand customer value proposition while modernizing our operating model through tailored distribution support and enhancing the underwriting process. Basic mortality protection solutions are provided through less complex products, such as term and whole life insurance, sold primarily through exclusive agents and licensed sales professionals. More advanced mortality and financial planning solutions such as universal life are provided primarily through exclusive financial specialists in New York. Many Allstate exclusive agencies partner with exclusive financial specialists to deliver life and retirement solutions. These specialists have expertise with advanced life and retirement cases and other financial needs of customers. Successful partnerships assist agencies with building stronger and deeper customer relationships. Sales producer education and technology improvements are being made to ensure agencies have the tools and information needed to help customers meet their needs and build personal relationships as trusted advisors.

The Company exited the continuing sale of annuities over an eight-year period from 2006 to 2014, reflecting expectations of declining returns. As a result, the declining volume of business is managed with a focus on increasing lifetime economic value. Both the deferred and immediate annuity businesses have been adversely impacted by the historically low interest rate environment. The immediate annuity business has also been impacted by medical advancements that have resulted in annuitants living longer than anticipated when many of these contracts were originated. The Company focuses on the distinct risk and return profiles of the specific products when developing investment and liability management strategies. The level of legacy deferred annuities in force has been significantly reduced and the investment portfolio and crediting rates are proactively managed to improve the profitability of the business while providing appropriate levels of liquidity. The investment portfolio supporting immediate annuities is managed to ensure the assets match the characteristics of the liabilities and provide the long-term returns needed to support this business. To better match the long-term nature of immediate annuities, the Company continues to increase performance-based investments in which we have ownership interests and a greater proportion of return is derived from idiosyncratic asset or operating performance. While the Company anticipates higher returns on these investments over time, the investment income can vary significantly between periods. The Company continues to review strategic options to reduce exposure and improve returns of the business. As a result, the Company may take additional operational and financial actions that offer return improvement and risk reduction opportunities.

Effective January 1, 2017, ALIC and ALIC Re entered into an external reserve financing arrangement which replaced the \$325 million affiliated surplus note arrangement in place as of December 31, 2016. The external financing resulted in increasing the ALIC Re's surplus note capacity to accommodate the expansion of the existing reinsurance

agreement with ALIC effected contemporaneously. The refinancing was comprised of reinsurance and financing transactions as follows:

ALIC and the ALIC Re entered into the Amended and Restated Reinsurance Agreement ("Amended Reinsurance Agreement") effective January 1, 2017. The original reinsurance agreement included guaranteed term business written by ALIC and Lincoln Benefit Life Company ("LBL"), in 2000 through 2009. The Amended Reinsurance Agreement expanded the covered business to include guaranteed term business written by LBL and Allstate Assurance Company ("AAC"), an affiliate, with issue years 2010 through 2017. The LBL and AAC businesses were ceded to ALIC and retroceded to ALIC Re. In addition, the Amended Reinsurance Agreement revised, as of the effective date, the experience rated refund formula to utilize Actuarial Guideline XLVIII ("AG48") reserves and added additional conditions for experience rated refund payments, including an explicit holdback of \$150 million to fund future income tax payments which will become payable when future income is earned on the business. Upon implementation of the Amended Reinsurance Agreement, a \$292 million experience refund payable from ALIC Re to ALIC was established. The experience rated refund was paid by ALIC Re to ALIC in March 2017. As a result of the expanded reinsurance transaction, ALIC Re recognized a tax benefit of \$292 million on the taxable reinsurance loss of assuming the excess XXX reserves. On March 14, 2017, ALIC borrowed on a short-term basis from the Corporation under the Amended and Restated Intercompany Liquidity Agreement \$311 million to settle the ALIC Re's tax benefit associated with the January 1, 2017 transactions as well as ALIC Re's 2016 losses. ALIC paid the amount to ALIC Re's on March 15, 2017 as permitted under the tax sharing agreement. The intercompany transactions were appropriately eliminated on consolidation and net gains or losses were appropriately recorded from the transactions.

Also, effective January 1, 2017, pursuant to South Carolina Code 38-90-530(A), ALIC Re holds the outstanding principal amount of a variable funding puttable note issued by Bueller Financing, LLC ("Bueller") and referred to as a credit-linked note ("CLN") in ALIC Re's captive insurance trust as a form of security acceptable by the Director. The CLN was issued in conjunction with a Master Transactions Agreement ("MTA") between ALIC Re and Bueller. The CLN amount is calculated as and will vary with the amount of Commissioners Reserve Valuation Method ("CRVM") reserves on the reinsured business in excess of the Actuarial Guideline XLVIII ("AG48") reserves, with a maximum value of \$1.75 billion. As the National Association of Insurance Commissioners ("NAIC") Accounting Practices and Procedures Manual does not explicitly identify the form of the CLN, ALIC Re obtained permission from the South Carolina Department of Insurance ("SC DOI") to record the outstanding principal amount of \$1.30 billion as of December 31, 2017 as an admitted asset on Page 2, Line 25 of the Assets page and within capital and surplus on Page 3, Line 34 of the Liabilities, Surplus and Other Funds page. The CLN is recorded in the same way in the Company's financial statement as it was recorded on ALIC Re's standalone financial statement.

Pursuant to the Surplus Note Purchase Agreement, ALIC is authorized to purchase up to \$750 million of such notes issued by ALIC Re. As of December 31, 2016, ALIC has purchased four notes totaling \$325 million; two \$100 million notes on July 1, 2005 and May 25, 2006, a \$50 million note on May 28, 2008, a \$25 million note on December 18, 2009, and a \$50 million note on April 26, 2016. Effective January 1, 2017, with the permission of the SC DOI, ALIC Re redeemed at par value, plus \$1 million of accrued interest, all the surplus notes it had issued to ALIC through the transfer of cash and securities. Upon repayment of the surplus notes, the intercompany note agreements between ALIC and its affiliate, Kennett Capital, Inc. ("Kennett") totaling \$325 million par, plus accrued interest, were terminated.

On December 22, 2016, ALIC purchased \$279 million of bonds issued by Allstate Finance Company Agency Loans, LLC ("AFCAL"), an affiliate. AFCAL is a special purpose entity wholly-owned by Allstate Non-insurance Holdings, Inc., which is wholly-owned by the Corporation. The purpose of AFCAL is limited to purchasing and securitizing fixed rate and term agent loans from Allstate Finance Company, LLC ("AFCO"), a wholly-owned subsidiary of ALIC, at fair value. AFCO originates commercial loans to exclusive insurance agents of AIC generally for the purpose of acquiring agencies or books of business and refinancing existing agent debt. The transaction is structured as a loan securitization with oversight by a trustee and a servicer managing the portfolio. AFCAL purchased the agent loans and used them as collateral in the issuance of bonds to its affiliates, which are the sole source of cash flows for debt service. AFCO does not have any rights or obligations to repurchase the loans.

On December 2, 2016, ALIC purchased for cash a \$40 million 3.07% surplus note due December 2, 2036 that was issued by AAC. No payment of principal or interest is permitted on the surplus note without the written approval from the proper regulatory authority. The regulatory authority could prohibit the payment of interest and principal on the surplus notes if certain statutory capital requirements are not met.

FINANCIAL POSITION

BALANCE SHEET

(in millions)	2017	2016
Cash and invested assets	\$ 33,010	\$ 33,663
Premiums and considerations	446	396
Net deferred tax assets	32	231
Aggregate writes ins for other invested assets	1,300	-
Other assets	362	394
From Separate Accounts, Segregated Accounts and Protected Cell Accounts	3,851	3,841
Total assets	<u>\$ 39,001</u>	<u>\$ 38,525</u>
Aggregate reserves for life contracts	\$ 26,357	\$ 26,771
Aggregate reserves for accident and health contracts	112	114
Liability for deposit-type contracts	2,586	2,780
Contract claims and liabilities	211	158
Asset valuation reserve	1,052	862
Other liabilities	970	856
From Separate Accounts Statement	3,851	3,841
Total liabilities	<u>35,139</u>	<u>35,382</u>
Capital and surplus	3,862	3,143
Total liabilities and capital and surplus	<u>\$ 39,001</u>	<u>\$ 38,525</u>

Cash and invested assets

Total invested assets decreased \$653 million, or 2%, as of December 31, 2017 and was primarily due to \$600 million dividends paid to AIC, a \$331 million decrease in net deposits on deposit-type contracts and repayment of a \$325 million intercompany note agreement with Kennett, partially offset by \$495 million of net capital gains on investments and \$128 million cash from operations.

Portfolio composition by investment strategy

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

(in millions)	2017			2016	
	Market- Based Core	Market- Based Active	Performance- Based	Total	Total
Bonds	\$ 21,396	\$ 1,014	\$ 20	\$ 22,430	\$ 23,402
Preferred stocks	27	3	12	42	30
Common stocks	1,242	162	47	1,451	1,364
Mortgage loans on real estate	3,805	-	-	3,805	3,838
Real estate	-	-	110	110	95
Cash and cash equivalents	528	-	-	528	472
Short-term investments	176	10	1	187	274
Contract loans	595	-	-	595	596
Other invested assets	724	-	3,008	3,732	3,510
Derivatives	93	-	-	93	78
Securities lending reinvested collateral assets	7	-	-	7	2
Other	30	-	-	30	2
Total	<u>\$ 28,623</u>	<u>\$ 1,189</u>	<u>\$ 3,198</u>	<u>\$ 33,010</u>	<u>\$ 33,663</u>
% of total	87%	3%	10%		

The Company continues to increase performance-based investments in the portfolio, consistent with the ongoing strategy to have a greater proportion of the return derived from idiosyncratic asset or operating performance. Invested assets and market-based income are expected to decline in line with reductions in contractholder funds and income related to performance-based investments tend to increase the variability of earnings. Additionally, investment income may decline to the extent the Company reinvests investment proceeds at market yields that are below the current portfolio yield.

The return on the investment portfolio is an important component of the Company's ability to offer good value to customers and earn an acceptable return on capital. The Company identifies a strategic asset allocation which considers both 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 long-term 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. The Company manages risks that involve uncertainty related to interest rates, credit spreads, equity returns and currency exchange rates.

The Company's portfolio is comprised of assets chosen to generate returns to support corresponding liabilities, within an asset-liability framework that targets an appropriate return on capital. For longer-term immediate annuity liabilities, the Company invests primarily in performance-based investments, such as limited partnerships, and common stocks. For shorter-term annuity and life insurance liabilities, the Company invests primarily in fixed income securities and commercial mortgage loans with maturity profiles aligned with liability cash flow requirements.

The Company utilizes two primary 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 be moved between strategies.

Market-based strategies include investments primarily in publicly traded bonds and common stocks. Market-based core seeks to deliver predictable earnings aligned to business needs and returns consistent with the markets in which the Company invests. Private fixed income assets, such as commercial mortgages, bank loans and privately placed debt that provide liquidity premiums are also included in this category. As of December 31, 2017, 87% of the portfolio follows this strategy with 88% in bonds and commercial mortgage loans and 4% in common stocks. Market-based active seeks to outperform within the public markets through tactical positioning and by taking advantage of short-term opportunities. This category may generate results that meaningfully deviate from those achieved by market indices, both favorably and unfavorably. As of December 31, 2017, 3% of the portfolio follows this strategy with 85% in bonds and 14% in common stock.

Performance-based strategy seeks to deliver attractive risk-adjusted returns and supplement market risk with idiosyncratic risk. Returns are impacted by a variety of factors including general macroeconomic and public market conditions as public benchmarks are often used in the valuation of underlying investments. The portfolio, which primarily includes private equity and real estate with a majority being limited partnerships, 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 often enhance returns and income through transformation at the company or property level. A portion of these investments seek returns in markets or asset classes that are dislocated or special situations, primarily in private markets. As of December 31, 2017, 10% of the portfolio follows this strategy with 94% in other invested assets primarily invested in limited partnerships.

The Company has a comprehensive portfolio monitoring process to identify and evaluate each security whose carrying value may be other-than-temporarily impaired. The 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) or cost (for stocks) is below established thresholds. The process also includes monitoring of other impairment indicators such as ratings, rating downgrades and payment defaults.

Bonds

Bonds decreased \$972 million from the prior year primarily due to \$600 million dividends paid to AIC and repayment of \$325 million intercompany note agreement with Kennett.

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

As of December 31, 2017, 86% of the consolidated bond portfolio was rated investment grade, which is defined as a security having an National Association of Insurance Commissioners ("NAIC") designation of 1 or 2, a rating of Aaa, Aa, A, or Baa from Moody's, a rating of AAA, AA, A or BBB from S&P Global Ratings, a comparable rating from another nationally recognized rating agency or a comparable internal rating if an externally provided rating is not available. 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 structured securities and excluding SVO-identified investments, 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 as unrealized capital loss.

Corporate bonds totaled \$17.70 billion and \$17.71 billion as of December 31, 2017 and 2016, respectively. The bond portfolio contained \$12.31 billion and \$12.35 billion of publicly traded corporate bonds as of December 31, 2017 and 2016, respectively. As of December 31, 2017, 87% of the publicly traded corporate bonds were rated investment grade. As of December 31, 2017, the portfolio also contained \$5.39 billion of privately placed corporate securities compared to \$5.36 billion as of December 31, 2016. 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 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, 2017, 75% of the privately placed securities were rated investment grade.

Municipal bonds totaled \$1.95 billion as of December 31, 2017 compared to \$1.96 billion as of December 31, 2016. 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). As of December 31, 2017, 100% of the municipal bonds were rated investment grade. The municipal bond portfolio as of December 31, 2017 consisted of 269 issues from 145 issuers. The largest exposure to a single issuer was 6% of the municipal bond portfolio.

The bond portfolio also contained \$1.31 billion and \$1.77 billion of ABS as of December 31, 2017 and 2016, 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. As of December 31, 2017, 85% of the ABS securities were rated investment grade.

U.S. government bonds totaled \$1.02 billion and \$1.25 billion as of December 31, 2017 and 2016, respectively.

As of December 31, 2017 and 2016, \$297 million and \$527 million, 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. As of December 31, 2017, 94% of the MBS portfolio were rated investment grade.

Foreign government bonds totaled \$146 million as of December 31, 2017 compared to \$180 million as of December 31, 2016. As of December 31, 2017, substantially all of the foreign government bonds were rated investment grade.

The fair value of all bonds was \$23.70 billion and \$24.52 billion as of December 31, 2017 and 2016, respectively. Unrealized net capital gains on the bond portfolio, which are calculated as the difference between statement value and fair value, were \$1.27 billion and \$1.12 billion as of December 31, 2017 and 2016, respectively.

Common stocks

Common stocks increased \$87 million to \$1.45 billion as of December 31, 2017 primarily driven by strong equity market performance.

Mortgage loans on real estate

Mortgage loans on real estate decreased \$33 million to \$3.81 billion as of December 31, 2017. The decrease was due to reallocation to other investments. 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 did not record realized capital losses related to other-than-temporary impairments on mortgage loans for the years ended December 31, 2017 or 2016. For the years ended December 31, 2017 and 2016, the Company did not report valuation allowances on mortgage loans.

Other invested assets

Other invested assets increased \$222 million to \$3.73 billion as of December 31, 2017 mostly attributed to limited partnerships due to increased investment in support of the long-term performance based strategy. The limited partnership portfolio consisted of investments in private equity funds, real estate funds and other funds.

Off-balance sheet financial instruments

The contractual amounts of off-balance-sheet financial instruments as of December 31 were as follows:

(in millions)	<u>2017</u>	<u>2016</u>
Commitments to invest in limited partnership interests	\$ 1,345	\$ 1,400
Private placement commitments	\$ 47	\$ 13
Other loan commitments	\$ 17	\$ -

Commitments to invest in limited partnership interests represent agreements to acquire new or additional participation in certain limited partnership investments. The Company enters into these agreements in the normal course of business.

Private placement commitments represent commitments to purchase private placement debt and private equity securities at a future date. The Company enters into these agreements in the normal course of business.

Other loan commitments are agreements to lend to a borrower provided there is no violation of any condition established in the contract. The Company enters into these agreements to commit to future loan fundings at predetermined interest rates. Commitments have either fixed or varying expiration dates or other termination clauses.

The contractual amounts represent the amount at risk if the contract was fully drawn upon, the counterparty defaults and the value of any underlying security becomes worthless. The Company does not require collateral or other security to support off-balance-sheet financial instruments with credit risk.

Non-investment-grade investments

The Company's investment policy allows it to purchase and hold below investment grade securities. The Company believes with quality research and underwriting, these securities complement its broader investment strategy and provide the appropriate level of return for the increased risk.

Net deferred tax assets

Net deferred tax assets decreased \$199 million to \$32 million as of December 31, 2017 mostly due to the change in tax rate. On December 22, 2017, Public Law 115-97, known as the Tax Cuts and Jobs Act of 2017 ("Tax Legislation") became effective, permanently reducing the U.S corporate income tax rate from 35% to 21% beginning January 1, 2018. The Tax Legislation resulted in a revaluation of deferred tax assets and liabilities.

Aggregate write-ins for other than invested assets

As of December 31, 2017, aggregate write-ins for other than invested assets included \$1.30 billion CLN between ALIC Re and Bueller issued in conjunction with the MTA described previously.

Aggregate reserve for life contracts

(in millions)	<u>2017</u>	<u>2016</u>
Structured settlements	\$ 7,449	\$ 7,449
Interest sensitive life	6,771	6,703
Fixed annuities	5,379	5,893
Traditional life	2,923	2,615
Indexed annuities	968	995
Modified guaranteed annuity contracts	759	956
Annuity buyouts	699	751
Payout annuities	579	595
Single premium immediate annuities	343	394
Indexed life	404	337
Other	83	83
Total	<u>\$ 26,357</u>	<u>\$ 26,771</u>

Aggregate reserves for life contracts decreased \$0.41 billion to \$26.36 billion as of December 31, 2017 and were primarily attributed to reserve decreases of \$514 million for fixed annuities, \$197 million for modified guaranteed annuity ("MGA") contracts, \$52 million for annuity buyouts and \$51 million for single premium immediate annuities, partially offset by reserves increases for traditional life of \$308 million, interest sensitive life of \$68 million and indexed life of \$67 million. The decreases in reserves for fixed annuities, MGA, annuity buyouts and single premium immediate annuities were primarily due to continued run-off of the annuity business. The increase in reserves for traditional life was primarily due to coinsurance agreement between ALIC and AAC as AAC's term business with

issue years from 2015 to 2017 was reinsured to ALIC effective January 1, 2017. The increase in reserves for interest sensitive life was primarily driven by expected progression on AXXX reserves. The increase in reserves for indexed life was primarily driven by premiums and credited interest exceeding surrenders and withdrawals.

Liability for deposit-type contracts

Liability for deposit-type contracts decreased \$194 million to \$2.59 billion as of December 31, 2017 primarily due to run-off of structured settlements and the single premium immediate annuities.

Capital and surplus

(in millions)

	<u>2017</u>	<u>2016</u>
Capital and surplus, December 31, prior year	\$ 3,143	\$ 2,942
Net income (loss)	279	192
Change in net unrealized capital gains (losses)	415	68
Change in net unrealized foreign exchange capital gains (losses)	63	8
Change in net deferred income tax	(208)	4
Change in nonadmitted assets	(15)	(13)
Change in asset valuation reserve	(190)	(108)
Change in surplus notes	(325)	50
Dividends to stockholders	(600)	-
Aggregate write-ins for gains and losses in surplus	<u>1,300</u>	<u>-</u>
Capital and surplus, December 31, current year	<u>\$ 3,862</u>	<u>\$ 3,143</u>

Capital and surplus increased \$719 million to \$3.86 billion as of December 31, 2017. The increase was mainly due to the \$1.30 billion CLN, \$478 million net after-tax unrealized capital gains and \$279 million current year net income, partially offset by \$600 million dividends paid to AIC, \$325 million reduction in surplus note, \$208 million change in net deferred income tax, \$190 million increase in asset valuation reserve ("AVR") and \$15 million increase in nonadmitted assets. The change in net deferred income tax was primarily due to the Tax Legislation discussed above. The tax effect of the rate change from the Tax Legislation and the reduction in surplus was \$21 million in 2017. The increase in AVR was primarily due to increased unrealized capital gains on other invested assets.

RESULTS OF OPERATIONS

(in millions)

	<u>2017</u>	<u>2016</u>
Premiums and annuity considerations	\$ 1,598	\$ 1,472
Net investment income including IMR amortization	1,599	1,584
Commissions and expense allowances on reinsurance ceded	67	77
Reserve adjustments on reinsurance ceded	(527)	(529)
Other income	39	38
Total revenue	<u>2,776</u>	<u>2,642</u>
Provision for benefits	2,532	2,607
Commissions and general insurance expenses	432	354
Insurance taxes, licenses and fees, excluding federal income taxes	27	22
Net transfers to or (from) Separate Accounts	(586)	(590)
Transfer of IMR due to reinsurance agreement	1	-
Total expense	<u>2,406</u>	<u>2,393</u>
Net gain from operations before dividends to policyholders and before federal income taxes	370	249
Federal and foreign income taxes incurred (excluding tax on capital gains)	<u>88</u>	<u>1</u>
Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains (losses)	282	248
Realized gains (losses), net of IMR and federal income taxes	<u>(3)</u>	<u>(56)</u>
Net income	<u>\$ 279</u>	<u>\$ 192</u>

Net income

The Company reported net income of \$279 million and \$192 million for 2017 and 2016, respectively. The \$87 million increase in net income was due to \$126 million increase in premiums and annuity considerations, a \$75 million decrease in provision for benefits, a \$53 million decrease in realized losses net of IMR and federal income taxes and \$15 million increase in net investment income including IMR amortization, partially offset by \$87 million increase in federal and foreign income taxes incurred, \$78 million increase in commissions and general insurance expenses and \$10 million decrease in commissions and expense allowances on reinsurance ceded.

Premiums and annuity considerations

Premiums and annuity considerations increased \$126 million compared to 2016 primarily due to a \$150 million increase in traditional life mostly driven by higher traditional life premiums related to the coinsurance agreement with AAC effective January 1, 2017 and a \$19 million increase in accident and health premiums due to growth in voluntary accident and health insurance, partially offset by a \$26 million decrease in interest sensitive life due to organizational decision to use AAC as the primary writing company for new life business.

Net investment income including IMR amortization

Net investment income including IMR amortization increased \$15 million, or 1%, mostly attributed to derivatives and strong performance-based results primarily from limited partnerships.

Provision for benefits

Provisions for benefits decreased \$75 million compared to 2016 primarily due to decreases in surrenders, annuity benefits, interest on deposit-type funds and change in reserves of \$59 million, \$36 million, \$10 million and 7 million, respectively, partially offset by an increase in death benefits and disability benefits of \$26 million and \$11 million, respectively. The decrease in surrenders was primarily attributed to MVAA, fixed annuities and indexed annuities of \$26 million, \$26 million and \$15 million, respectively, primarily due to run off of the block. The decrease in annuities benefits was primarily attributed to payout annuities due to run off of the annuity block. The \$7 million decrease in the change in reserves was mostly attributed to structured settlements, MVAA and fixed annuities driven by a smaller decline year over year in the run off of the reserves of \$142 million, \$59 million and \$38 million, respectively. Reserves for interest sensitive life decreased \$34 million mostly due to organizational decision to use AAC as the primary writing company for new life business. The decrease in the change in reserves was partially offset by an increase in indexed annuities, traditional life and payout annuities of \$124 million, \$112 million and \$19 million, respectively. The increase in reserves for indexed annuities was primarily due to Actuarial Guideline 50 IL Administrative Code 1410 that was implemented in the fourth quarter of 2016 that allocated reserves among product based on market risk, causing increased reserves allocated to market value adjusted deferred annuity products due to higher market risk. The increase in reserves for traditional life was mostly due to higher premiums related to the coinsurance agreement with AAC described previously.

Federal and foreign income taxes incurred

Federal and foreign incomes taxes incurred increased \$87 million compared to 2016 primarily due to an increase in net gain from operations before federal income taxes.

Realized losses net of IMR and federal income taxes

The \$53 million decrease in realized losses net of IMR and federal income taxes was mostly due to less write-downs taken for bonds, stocks and limited partnerships in 2017 compared to 2016.

CASH FLOW AND LIQUIDITY

The following table summarizes cash flow.

(in millions)	2017	2016
Net cash from operations	\$ 127	\$ (56)
Net cash from investments	843	343
Net cash from financing and miscellaneous sources	(1,001)	(386)
Net change in cash, cash equivalents and short-term investments	\$ (31)	\$ (99)

The principal sources of cash flows from operations were investment income, premiums and net transfers from Separate Accounts. The principal uses were the payment of benefits and commissions and operating expenses. Net cash from operations increased \$184 million in 2017 compared to 2016 primarily due to higher premiums and higher net investment income and decreased benefits and loss related payments, partially offset by higher commissions.

Higher cash provided by investing activities in 2017 compared to 2016 was the result of proceeds from bonds in excess of acquisition cost. The maturity structure of the Company's bonds, which represent 68% 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 net negative cash flows from financing and miscellaneous sources was due to \$600 million dividends paid to AIC and net withdrawals on deposit-type contracts, mainly due to scheduled distributions of maturing funding agreements.

Liquidity for life insurance companies is measured by the ability to pay contractual benefits and operating expenses, and fund investment commitments. Annuity reserves, including liability for deposit-type contracts, as of December 31, 2017, excluding Separate Accounts, consisted of \$18.77 billion, or 64%, of total reserves in force. Of the total annuity reserves, including liability for deposit-type contracts, \$12.28 billion, or 61%, 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), A+ (good) and A1 (good) by A.M. Best, S&P Global Ratings and Moody's, respectively; all with a stable outlook.

Dividend restriction

The ability of ALIC to pay dividends is generally dependent on business conditions, income, cash requirements, receipt of dividends and other relevant factors. More specifically, the Illinois Insurance Code ("Code") provides a two-step process. First, no dividend may be declared or paid except from earned (unassigned) surplus, as distinguished from contributed surplus, nor when the payment of a dividend reduces surplus below the minimum amount required by the Code. Secondly, a determination of the ordinary versus extraordinary dividends that can be paid is formula based and considers net income and capital and surplus, as well as the timing and amounts of dividends paid in the preceding twelve months as specified by the Code. Ordinary dividends to shareholders do not require prior approval of the IL DOI. Dividends are not cumulative. As of December 31, 2017, the maximum ordinary dividend that can be declared and paid in 2018 by ALIC is limited to \$847 million.

Risk-based capital

The NAIC has a uniform capital adequacy standard, referred to as 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, health credit and market 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, 2017, each of the insurers comprising the Company 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. As of December 31, 2017, none of the companies had four or more ratio results fall outside of the usual range.

Reinsurance

The Company's reinsurance ceded on life insurance inforce decreased \$4.44 billion to \$89.60 billion as of December 31, 2017 compared to \$94.04 billion as of December 31, 2016. Of the \$89.60 billion life insurance inforce ceded as of December 31, 2017, \$5.18 billion was ceded to AAC pursuant to the reinsurance agreement entered into by ALIC and AAC effective April 1, 2015 while the rest was ceded to unaffiliated reinsurers. The Company enters into reinsurance agreements with unaffiliated reinsurers to limit aggregate and single exposure to losses on large risks, while retaining primary liability as a direct insurer for all risks ceded to reinsurers.

As of December 31, 2017 and 2016, 21% and 23%, respectively of the Company's face amount of life insurance inforce 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, 2017, 78% and 13% 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 and two companies with a rating of B, respectively. The rest was ceded to companies that are not rated by A.M. Best.