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**Allstate Insurance Group
Combined Management Discussion and Analysis
For the Year Ended December 31, 2019**

OVERVIEW

The Allstate Insurance Group (referred to as the "Group") consists of Allstate County Mutual Insurance Company, Allstate Fire and Casualty Insurance Company ("AFCIC"), Allstate Indemnity Company ("AI"), Allstate Insurance Company ("AIC"), Allstate Northbrook Indemnity Company, Allstate North American Insurance Company, Allstate Property and Casualty Insurance Company ("APC"), Allstate Texas Lloyd's, Allstate Vehicle and Property Insurance Company, Encompass Home and Auto Insurance Company ("EHAIC"), Encompass Indemnity Company ("EI"), Encompass Independent Insurance Company ("EIIC"), Encompass Insurance Company ("EIC"), Encompass Insurance Company of America ("EICA"), Encompass Insurance Company of Massachusetts ("EICMA"), Encompass Property and Casualty Company ("EPC"), Esurance Insurance Company ("ESIC") 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").

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"), which offers traditional, interest-sensitive and variable life insurance products through Allstate exclusive agents and exclusive financial specialists. 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, 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, Puerto Rico and Canada 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

The Group has implemented a multi-year Transformative Growth Plan that leverages the Allstate brand, people and technology. The plan has three components: expanding customer access, improving customer value and increasing investments in marketing and technology. This plan is focused on the customer experience, providing a circle of protection through people and technology along with increased connectivity, combined with distribution, product, and technology enhancements. As part of the Transformative Growth Plan, the Group will enable consumers to select a method of interaction and Esurance will be integrated into the Allstate brand in 2020.

The Group's property-liability operations consist of Allstate Protection and Discontinued Lines and Coverages segments. Allstate Protection includes the Allstate®, Encompass® and Esurance® brands and offers private passenger auto, homeowners, other personal lines and commercial insurance through agencies, contact centers and online. Esurance will be integrated into the Allstate brand in 2020 as we are repositioning the Allstate brand for broader customer access. Discontinued Lines and Coverages relates to property and casualty insurance policies written during the 1960's through the mid-1980's. 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 consumers online and through contact centers,

while the Encompass brand serves brand-neutral customers who prefer personal service and support from an independent agent. Esurance will be integrated into the Allstate brand in 2020.

The Allstate brand utilizes targeted marketing which includes messaging that communicates the value of the Group's "Good HandsSM", the importance of having proper coverage, product options, and the ease of doing business with Allstate.

The Allstate brand differentiates itself by offering comprehensive product options and features with access to agencies that provide local advice and service. The Your Choice Auto[®] product offers qualified customers choice from a variety of options such as Accident Forgiveness, Deductible Rewards[®], Safe Driving Bonus[®] and New Car Replacement. The Allstate House and Home[®] product features options that include Claim RateGuard[®], Claim-Free Bonus, Deductible RewardsSM and 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 standard auto insurance customers dissatisfied with their claims experience. Bundling Benefits provides auto customers with a qualifying property policy an auto renewal guarantee and a deductible waiver (when the same event, with the same covered cause of loss, damages both auto and property). Bundling Benefits was offered in 39 states as of December 31, 2019. The New Car Replacement Protection replaces a qualifying customer's vehicle (two model years old or less) involved in a total loss accident with a vehicle of the same or similar make and model. New Car Replacement Protection was offered in 39 states as of December 31, 2019. The Drivewise[®] program is a telematics-based program, available in 50 states and the District of Columbia as of December 31, 2019, that uses a mobile application or an in-car device to capture driving behaviors and encourage safe driving. The Drivewise program provides customers with information and tools, incentives and driving challenges. For example, in most states, Allstate Rewards[®] provides reward points for safe driving. Milewise[®], Allstate's usage-based insurance product, available in 14 states as of December 31, 2019, gives customers flexibility to customize their insurance and pay based on the number of miles they drive.

When an Allstate product is not available, the Group may offer non-proprietary products to consumers through Ivantage and arrangements made with other companies, agencies, and brokers.

Other personal lines sold under the Allstate brand include renters, condominium, landlord, boat, umbrella, manufactured home and stand-alone scheduled personal property.

The Group's strategy for the Esurance brand is to make insurance surprisingly painless by innovating to make it simple, transparent, and affordable with a seamless online and mobile experience. Esurance will be integrated into the Allstate brand in 2020.

Currently, customers who prefer an independent agent can access products under either the Encompass or Allstate brand. As part of Allstate's multi-year Transformative Growth Plan, independent agent access will be increased as we combine our Allstate and Encompass brand independent agency businesses and go to market exclusively with the Encompass brand. In addition to bringing the organizations together, we will expand the independent agency footprint, provide a superior agency and customer experience, and offer contemporary products with sophisticated pricing. Over the past several years, Encompass has been executing a profit improvement plan emphasizing pricing, governance and operational improvements at both the state and countrywide levels. These actions have improved underlying profitability but led to a reduction of policies in force compared to prior years for both auto and homeowners. We expect these profit improvement actions to continue as we implement the Transformative Growth Plan.

The Group's pricing and underwriting strategies and decisions are designed to generate sustainable profitable growth. The Group's proprietary database of underwriting and loss experience enables sophisticated pricing algorithms and methodologies to more accurately price risks while also seeking 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 and growth. The Group's pricing strategy involves local marketplace pricing and underwriting decisions based on risk evaluation factors to the extent permissible by applicable law and an evaluation of competitors.

Pricing of property products is intended to generate risk-adjusted returns that are acceptable over a long-term period. The Group pursues rate increases to keep pace with loss trends, including losses from catastrophic events and those that are weather-related (such as wind, hail, lightning and freeze not meeting the criteria to be declared a catastrophe) The Group also takes into consideration potential customer disruption, the impact on its ability to market our products, regulatory limitations, competitive position and

profitability. 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 incorporated into product pricing.

CATASTROPHE MANAGEMENT

Catastrophe losses are an inherent risk of the property and casualty 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. The average premium on a property policy near these coasts is generally 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 by our participation in various state facilities. However, the impact of these actions may be diminished by the growth in insured values, and the effect of state insurance laws and regulations. In addition, in various states the Group is required to participate in assigned risk plans, reinsurance facilities and joint underwriting associations that provide insurance coverage to individuals or entities that otherwise are unable to purchase such coverage from private insurers. Because of the Group's participation in these and other state facilities such as wind pools, it may be exposed to losses that surpass the capitalization of these facilities and to assessments from these facilities.

The Group 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.
- We began to write a limited number of homeowners policies in select areas of California in 2016. 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. The Group has decreased the overall homeowner exposures in California by more than 50% since 2007.
- In certain states, the Group has been ceding wind exposure related to insured property located in wind pool eligible areas.
- Tropical cyclone deductibles are generally higher than all peril deductibles and are in place for a large portion of coastal insured properties.
- Auto comprehensive damage coverage generally includes coverage for flood-related loss. We have additional catastrophe exposure, beyond the property lines, for auto customers who have purchased comprehensive damage coverage
- Offer a homeowners policy available in 43 states, Allstate House and Home[®], that provides options of coverage for roof damage including graduated coverage and pricing based on roof type and age.

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 adequate risk adjusted returns can be achieved.

DODD-FRANK: COVERED AGREEMENT

The Secretary of the Treasury (operating through FIO) and the Office of the U.S. Trade Representative (“USTR”) are jointly authorized, pursuant to the Dodd-Frank, to negotiate Covered Agreements. A Covered Agreement is a 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.”

On September 22, 2017, the U.S. and European Union (“EU”) signed a Covered Agreement. In addition to signing the Covered Agreement, Treasury and the USTR jointly issued a policy statement clarifying how the U.S. views implementation of certain provisions of the Covered Agreement. The policy statement affirms the U.S. system of insurance regulation, including the role of state insurance regulators as the primary supervisors of the business of insurance and addresses several other key provisions of the Covered Agreement for which constituents sought clarity, including prospective application to reinsurance agreements and an affirmation that the Covered Agreement does not require development of a group capital standard or group capital requirement in the U.S.

The U.S. has five years from the date of signing to amend its credit for reinsurance laws and regulations to conform with the requirements of the Covered Agreement or face federal preemption determinations by the FIO. To address the requirements of the Covered Agreement, the National Association of Insurance Commissioners (“NAIC”) has formally adopted revisions to its existing credit for reinsurance model law and model regulation to conform with the requirements of the Covered Agreement with the expectation that states will adopt and implement the modified model law and regulation by September 2022.

On December 19, 2018, the U.S. and the United Kingdom (“UK”) signed a separate Covered Agreement consistent with the U.S.-EU Covered Agreement to coordinate regulation of the insurance industry doing business in the U.S. and UK in the event the UK leaves the EU. Consistent with the U.S.-EU Covered Agreement signed in 2017, Treasury and the USTR also issued a policy statement regarding implementation of the Agreement affirming the role that state insurance regulators play as the primary supervisors of the U.S. insurance industry. The Agreement will become effective once U.S. and UK governments exchange written notifications that they have completed all domestic internal requirements and procedures. This is anticipated to occur when the UK is no longer covered by the Agreement following the UK withdrawal from the EU.

DIVISION STATUTE

On November 27, 2018, the Illinois General Assembly passed legislation authorizing a statute that makes available a process by which a domestic insurance company may divide into two or more domestic insurance companies. The statute, which became effective January 1, 2019, can be used to divide continuing blocks of insurance business from insurance business no longer marketed, or otherwise has been discontinued, into separate companies with separate capital. The statute can also be used for sale to a third party or to manage risks associated with indemnification programs. Before a plan of division can be effected it must be approved according to the organizational documents of the dividing insurer and submitted for approval by the Illinois Department of Insurance.

FINANCIAL POSITION

(in millions)

	<u>2019</u>	<u>2018</u>
Cash and invested assets	\$ 47,196	\$ 43,559
Investment income due and accrued	278	265
Premiums and considerations	5,168	4,940
Current federal and income tax recoverable	-	10
Net deferred tax asset	551	716
Receivables from parent, subsidiaries and affiliates	202	235
Other assets	286	233
Total assets	<u>\$ 53,681</u>	<u>\$ 49,958</u>
Losses and loss adjustment expenses	\$ 18,055	\$ 17,618
Commissions payable, contingent commissions and other similar charges	206	198
Other expenses	1,277	1,332
Current federal and foreign income taxes	189	-
Unearned premiums	11,104	10,650
Advance premiums	302	290
Payable to parent, subsidiaries and affiliates	184	201
Payable for securities lending	1,275	920
Accounts payable	309	305
Payable for securities	356	245
Other liabilities	537	520
Total liabilities	<u>33,794</u>	<u>32,279</u>
Capital and surplus	<u>19,887</u>	<u>17,679</u>
Total liabilities and capital and surplus	<u>\$ 53,681</u>	<u>\$ 49,958</u>

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. Products with lower liquidity needs, such as auto insurance and discontinued lines and coverages, and capital create capacity to invest in less liquid higher yielding bond securities, performance-based investments such as limited partnerships and equity securities. Products with higher liquidity needs, such as homeowners insurance, are invested primarily in high quality liquid bond securities.

The Group 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 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 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 move between strategies.

Market-based strategy includes investments primarily in public bonds and equity securities. It seeks to deliver predictable earnings aligned to business needs and to take advantage of short-term opportunities primarily through public and private bond investments and public equity securities. As of December 31, 2019, 88% of the portfolio follows this strategy with 70% in bonds and 24% in common stocks.

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. Variability in earnings will also result from the performance of the underlying assets or business and the timing of sales of those investments. Earnings from the sales of investments may be recorded as net investment income or realized capital gains and losses. 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, 2019, 12% of the portfolio follows this strategy with 84% in other invested assets primarily invested in limited partnerships.

Portfolio composition by investment strategy

The Group continues to increase performance-based investments in the portfolio consistent with the ongoing strategy to have a greater proportion of return derived from idiosyncratic assets or operating performance.

The Group has a comprehensive portfolio monitoring process to identify and evaluate each security that 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 following table presents the investment portfolio by strategy as of December 31:

(\$ in millions)	2019			2018
	Market-based core	Performance-based	Total	Total
Bonds	\$ 29,073	\$ 104	\$ 29,177	\$ 28,836
Preferred stocks	74	10	84	115
Common stocks	9,657	499	10,156	7,992
Mortgage loans on real estate	539	-	539	390
Real estate	31	323	354	347
Cash and cash equivalents	346	-	346	41
Short-term investments	787	-	787	743
Derivatives	20	-	20	113
Other invested assets	954	4,779	5,733	4,982
Total cash and invested assets	\$ 41,481	\$ 5,715	\$ 47,196	\$ 43,559
Percent to total	88%	12%	100%	

Total invested assets increased \$3.64 billion, or 8%, compared to prior year. Explanations for the more significant items follow.

Bonds

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

As of December 31, 2019, 83.8% of the consolidated bond portfolio was rated investment grade quality, which is defined as having a National Association of Insurance Commissioners ("NAIC") 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. There was no significant change in the bond portfolio quality distribution from the prior year.

Bonds with an NAIC designation of 1 or 2, including loan-backed and structured securities and excluding Securities Valuation Office-identified investments, 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.

Corporate public bonds totaled \$13.37 billion as of December 31, 2019 compared to \$13.59 billion as of December 31, 2018. As of December 31, 2019, the portfolio also contained \$5.89 billion of privately placed corporate obligations, compared to \$4.91 billion as of December 31, 2018. Corporate 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, 2019, 85% of the corporate public bonds and 54% of the corporate privately placed securities were rated investment grade.

Municipal bonds totaled \$5.62 billion as of December 31, 2019 compared to \$5.99 billion as of December 31, 2018. The municipal bond portfolio as of December 31, 2019 consisted of 3,588 issues and is made up of 925 issuers. The largest exposure to a single issuer was 2% of the municipal bond portfolio. Corporate entities were the ultimate obligors of less than 1% of the municipal bond portfolio. As of December 31, 2019, 100% of the Municipal bonds were rated investment grade.

U.S. government bonds totaled \$3.40 billion as of December 31, 2019 compared to \$3.38 billion as of December 31, 2018. As of December 31, 2019, 100% of the U.S. government bonds were rated investment grade.

ABS totaled \$670 million as of December 31, 2019 compared to \$705 million as of December 31, 2018. 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 \$170 million as of December 31, 2019 compared to \$212 million as of December 31, 2018. 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 \$55 million as of both December 31, 2019 and 2018.

The fair value of all bonds was \$30.18 billion and \$28.72 billion as of December 31, 2019 and 2018, respectively. As of December 31, 2019, unrealized net capital gains and losses on the bond portfolio, which are calculated as the difference between statement value and fair value, were \$1.01 billion unrealized gain compared to \$117 million unrealized loss as of December 31, 2018.

Equity securities

Equity securities include \$10.16 billion of common and \$84 million of non-redeemable preferred stocks, and investments in affiliates as of December 31, 2019 compared to \$7.99 billion of common and \$115 million of non-redeemable preferred stocks, and investments in affiliates as of December 31, 2018. The net increase was due to the increased investments in uncombined subsidiaries and equity markets.

Cash and cash equivalents

The \$305 million increase in cash and cash equivalents was due to higher securities lending balances throughout the year and the reinvestments predominantly in cash-like instruments.

Other invested assets

The \$751 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, 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)	2019	2018
Commitments to invest in limited partnership interests	\$ 1,778	\$ 1,832
Other loan commitments	\$ 57	\$ 43
Private placement commitments	\$ 47	\$ 40
Commitments to invest in real estate	\$ 9	\$ 9

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.

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.

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.

Commitments to invest in real estate represent an agreement to provide additional capital for the development of real estate property. The Company enters into these agreements in the normal course of business.

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.

Reserves for losses and loss adjustment expenses

Incurred losses and loss adjustment expenses represent the sum of paid losses, loss adjustment expenses and reserve changes in the calendar year. This expense included net losses from catastrophes of \$2.50 billion and \$2.67 billion in 2019 and 2018, respectively. Activity in the reserve for losses and loss adjustment expenses is summarized as follows:

(in millions)	<u>2019</u>	<u>2018</u>
Balance at January 1	\$ 17,618	\$ 17,102
Incurred related to		
Current year	22,017	20,958
Prior years	(49)	(229)
Total incurred	<u>21,968</u>	<u>20,729</u>
Paid related to:		
Current year	14,014	13,454
Prior years	7,517	6,759
Total paid	<u>21,531</u>	<u>20,213</u>
Balance as of December 31	<u>\$ 18,055</u>	<u>\$ 17,618</u>

Incurred losses and loss adjustment expenses attributable to insured events of prior years were \$(49) million and \$(229) million as a result of the reestimation of unpaid losses and loss adjustment expenses for the years ended December 31, 2019 and 2018, 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)	<u>NAIC Group Code</u>	<u>FEIN</u>	<u>2019</u>	<u>2018</u>
<u>Reinsurer</u>				
Michigan Catastrophic Claim Association ("MCCA")	0000	AA-9991159	\$ 5,503	\$ 5,399

The MCCA is a statutory indemnification mechanism for member insurers' qualifying personal injury protection claims paid for the unlimited lifetime medical benefits above the applicable retention level for qualifying injuries from automobile, motorcycle and commercial vehicle accidents. Indemnification

recoverables on paid and unpaid claims, including IBNR, as of December 31, 2019 and 2018 include \$5.50 billion and \$5.40 billion, respectively, from the MCCA for its indemnification obligation. The MCCA is funded by annually assessing participating member companies actively writing motor vehicle coverage in Michigan on a per vehicle basis that is currently \$220 per vehicle insured. The MCCA's calculation of the annual assessment is based upon the total of members' actuarially determined present value of expected payments on lifetime claims by all persons expected to be catastrophically injured in that year and ultimately qualify for MCCA reimbursement, its operating expenses, and adjustments for the amount of excesses or deficiencies in prior assessments. The assessment is incurred by the Company as policies are written and recovered as a component of premiums from the Company's customers. The MCCA indemnifies qualifying claims of all current and former member companies (whether or not actively writing motor vehicle coverage in Michigan) for qualifying claims and claims expenses incurred while the member companies were actively writing the mandatory personal injury protection coverage in Michigan. Member companies actively writing automobile coverage in Michigan include the MCCA annual assessments in determining the level of premiums to charge insureds in the state. As required for member companies by the MCCA, the Company reports covered paid and unpaid claims to the MCCA when estimates of loss for a reported claim are expected to exceed the retention level, the claims involve certain types of severe injuries, or there are litigation demands received suggesting the claim value exceeds certain thresholds. The retention level is adjusted upward every other MCCA fiscal year by the lesser of 6% or the increase in the Consumer Price Index. The retention level will be \$580 thousand per claim for the fiscal two-years ending June 30, 2021 compared to \$555 thousand per claim for the fiscal two-years ending June 30, 2019. The MCCA is obligated to fund the ultimate liability of member companies' qualifying claims and claim expenses. The MCCA does not underwrite the insurance coverage or hold any underwriting risk. The MCCA indemnifies members as qualifying claims are paid and billed by members to the MCCA. Unlimited lifetime covered losses result in significant levels of ultimate incurred claim reserves being recorded by member companies along with offsetting indemnification recoverables. Disputes with claimants over coverage on certain reported claims can result in additional losses, which may be recoverable from the MCCA, excluding litigation expenses. There is currently no method by which insurers are able to obtain the benefit of managed care programs to reduce claims costs through the MCCA. 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 June 30, 2022 to discount its liabilities for loss and loss adjustment expense. As of June 30, 2019, the date of its most recent annual financial report, the MCCA had cash and invested assets of \$21.83 billion and an accumulated surplus of \$1.28 billion. The permitted practice reduced the accumulated deficit by \$39.64 billion.

Capital and surplus

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

(in millions)	<u>2019</u>	<u>2018</u>
Common capital stock	\$ 46	\$ 51
Gross paid in and contributed surplus	4,015	4,051
Unassigned funds (surplus)	15,800	13,547
Aggregate write-ins for special surplus funds	26	30
Total surplus as regards policyholders	<u>\$ 19,887</u>	<u>\$ 17,679</u>

Total surplus as regards policyholders increased \$2.21 billion or 12%, and was mainly comprised of the following items:

- \$3.75 billion net income in 2019 compared to \$2.74 billion in 2018
- \$1.32 billion change in net unrealized capital gain in 2019 compared to \$374 million unrealized capital loss in 2018
- \$2.74 billion dividends paid to Allstate Holdings in 2019 compared to \$2.90 billion in 2018

RESULTS OF OPERATIONS

(in millions)	<u>2019</u>	<u>2018</u>
Premiums earned	\$ 32,155	\$ 30,386
Losses incurred	18,404	17,478
Loss adjustment expenses incurred	3,564	3,251
Other underwriting expenses incurred	<u>7,998</u>	<u>8,066</u>
Total underwriting deductions	<u>29,966</u>	<u>28,795</u>
Net underwriting gain	<u>2,189</u>	<u>1,591</u>
Net investment income earned	1,749	1,805
Net realized capital gains (losses)	<u>313</u>	<u>(278)</u>
Net investment gain	2,062	1,527
Total other income	<u>117</u>	<u>133</u>
Net income, after dividends to policyholders but before all other federal and foreign income taxes	4,368	3,251
Federal and foreign income taxes incurred	<u>616</u>	<u>513</u>
Net income	<u>\$ 3,752</u>	<u>\$ 2,738</u>

Net underwriting gain

The \$598 million increase in underwriting gain was mostly due to increased premiums earned and lower catastrophe losses, partially offset by higher non-catastrophe losses.

Net investment gains

Net investment gain increased \$535 million, mainly due to a net realized capital gain of \$313 million in 2019 compared to a net realized capital loss of \$278 million in 2018, primarily due to gains from common stocks and bonds. Net investment income earned decreased \$56 million compared to prior year due to a decrease in income from common stocks of \$175 million partially offset by the increase in income from bonds of \$127 million.

CASH FLOW AND LIQUIDITY

The following table summarizes cash flow.

(in millions)	<u>2019</u>	<u>2018</u>
Net cash from operations	\$ 4,264	\$ 3,777
Net cash from investments	(1,794)	(1,522)
Net cash from financing and miscellaneous sources	<u>(2,121)</u>	<u>(1,558)</u>
Net change in cash, cash equivalents and short-term investments	<u>\$ 349</u>	<u>\$ 697</u>

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 2019 as a result of an increase in premiums collected net of reinsurance and decrease in federal and foreign income taxes paid, partially offset by an increase in benefit and loss related payments and commissions. Higher negative net cash flows from investments in 2019 compared to 2018 were driven by lower investment proceeds, partially offset by lower investments acquired. Higher negative net cash flows from financing in 2019 compared to 2018 were due higher dividends paid to parent, partially offset by the increase in securities lending.

Dividend restriction

The ability of AIC, AFCIC, APC, AI, EI, EICA, EIIC, EHAIC, EIC and EPC 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, 2019, the maximum ordinary dividend that can be declared and paid in 2020 by AIC, AFCIC, APC, AI, EI, EICA, EIIC, EHAIC, EIC and EPC is limited to \$3.73 billion, \$1.4 million, \$1.3 million, \$0.8 million, \$0.6 million, \$0.4 million, \$0.4 million, \$0.4 million, \$0.3 million and \$0.3 million, respectively.

ESIC's ability to pay dividends in 2020 will be limited to \$4 million by the state insurance laws of the State of Wisconsin. Wisconsin law provides that the Company may pay out dividends without the prior approval of the Wisconsin Commissioner of Insurance in an amount, when added to other shareholder distributions made in the last 12 months, not in the excess of the lesser of (a) 10% of the insurer's surplus as regards to policyholders as of the prior year December 31 or (b) the greater of (1) its net income (excluding realized capital gains) for that same year end, (2) the aggregate of the net income of the insurer for the 3 calendar years preceding the date of the dividend or distribution, minus realized capital gains for those calendar years and minus dividends paid or credited and distributions made within the first 2 of the preceding 3 calendar years.

EICMA's ability to pay dividends is dependent on business conditions, income, cash requirements and other relevant factors. Without prior approval of the MA DOI, ordinary dividends to shareholder are limited to \$0.6 million. This amount is formula driven based on capital and surplus, as well as the timing and amount of dividends paid in the preceding twelve months as specified by Massachusetts insurance law. Dividends are not cumulative.

Financial strength ratings and outlook

The Company's most recent financial strength ratings and outlook were A+, Aa3 and AA- 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 the total adjusted 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, 2019, the total adjusted capital of each insurer comprising the Group was significantly above the company action level RBC.

Insurance Regulatory Information System ("IRIS") ratios

The NAIC has also developed a set of financial relationships or tests known as the IRIS 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, 2019, no insurer comprising the Group had more than two ratios outside the usual range.